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ABSTRACT

This report presents findings of an audit of the Principal Statements of the Department of Education's (ED) Federal Family Education Loan Program (FFELP) and its internal controls and compliance with laws and regulations for the fiscal years ending September 30, 1993, and September 30, 1992. The audit investigated whether the Principal Statements were reliable and whether relevant internal controls were in place and operating effectively, and tested compliance with significant provisions of selected laws and regulations. The audit found that the accuracy of the Statement of Financial Position, the Statement of Operation and Changes in Net Position, and the Statement of Budgetary Resources and Actual Expense could not be determined due to the lack of reliable student loan data. The Statement of Cash Flows was found to be fairly accurate. Material weaknesses in internal controls over determining program costs, effectively monitoring payments to guaranty agencies and lenders, and ensuring accurate financial reporting was found to have the potential for material losses of assets or misstatements in the principal statements. The Department's ability to achieve the program's mission of providing loan access to students at reasonable cost to taxpayers was seen as compromised. The pertinent financial statements, details of the audit design, additional reports, comments, and recommendations from 1992 are included. (JB)

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Report to the Congress
and the Secretary of
Education

June 1994

# FINANCIAL AUDIT

# Federal Family Education Loan Program's Financial Statements for Fiscal Years 1993 and 1992



/AIMD-94-131

ACN 17-30302

United States
General Accounting Office
Washington, D.C. 20548

U.S. Department of Education
Office of Inspector General
Washington, D.C. 20202

B-202873

June 30, 1994

To the President of the Senate and the
Speaker of the House of Representatives

In accordance with the Chief Financial Officers Act of 1990, GAO and the Department of Education's Office of the Inspector General audited the Principal Statements of the Department of Education's Federal Family Education Loan Program (FFELP) and its internal controls and compliance with laws and regulations for the fiscal year ended September 30, 1993. This report presents the results of this joint audit. It also describes Education's progress in developing better financial information and controls to more effectively manage the student loan program. Education fully cooperated with us and has begun significant efforts towards improving its financial information.

The significant matters this report discusses relate to determining program costs, effectively monitoring payments to guaranty agencies and lenders, and ensuring accurate financial reporting. We found that Education had material weaknesses in internal controls over each of these areas that could lead to material losses of assets or misstatements in the Principal Statements. These weaknesses undermine Education's ability to effectively and efficiently achieve the program's mission of providing loan access to all eligible students at a reasonable cost to taxpayers. Also, without adequate financial information, the Congress and Education's management cannot know the program's operating costs or the extent of Education's liability for loan defaults.

We are sending copies of this report to the Secretary of Education and other Department officials. We are also sending copies to the Secretary of the Treasury, the Director of the Office of Management and Budget, the Chairmen and Ranking Minority Members of the Senate Committee on Governmental Affairs and the House Committee on Government Operations, and other interested congressional committees. Copies will be made available to others upon request.

This report was prepared under the direction of John Hill, Director for Audit Support and Analysis, GAO's Accounting and Information Management Division, and Geraldine Jasper, Deputy Assistant Inspector General for Audit, Department of Education's Office of the Inspector General, who may be reached at (202) 512-8549 and (202) 205-8200,

respectively, if you or your staff have any questions. Other major contributors are listed in appendix IV.

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**Abbreviations**

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|---|---|
| CFO | Chief Financial Officer |
| FDSLP | Federal Direct Student Loan Program |
| FFELP | Federal Family Education Loan Program |
| GAO | General Accounting Office |
| NSLDS | National Student Loan Data System |
| OCFO | Office of the Chief Financial Officer |
| OIG | Office of the Inspector General |
| OMB | Office of Management and Budget |
| OPE | Office of Postsecondary Education |

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To the Secretary of Education

In accordance with the Chief Financial Officers (CFO) Act of 1990, the Department of Education prepared the accompanying Principal Statements for its Federal Family Education Loan Program (FFELP) for the fiscal years ended September 30, 1993 and 1992. Last year, GAO was unable to give an opinion on the fiscal year 1992 statements taken as a whole because reliable student loan data upon which to base the liabilities for loan guarantees was not available.[1] In addition, GAO reported that existing systems did not provide the necessary meaningful and reliable financial management information needed to effectively manage and report on the FFELP's operations. As a result of its audit for fiscal year 1992, GAO made 18 recommendations to Education; the status of Education's actions on these recommendations is disclosed in appendix II.

In response to GAO's audit reports covering fiscal year 1992, Education officials expressed their commitment to developing better financial management information and in establishing a sound internal control structure for the FFELP and the planned Federal Direct Student Loan Program. A number of corrective actions are underway, including the development of the National Student Loan Data System, the first national database of loan-by-loan information on over 40 million loans awarded to borrowers. In addition, Education is developing its first agencywide strategic management plan and has initiated efforts to design a system to identify key success measures for major programs and support services.

These initiatives ultimately should result in increased program accountability. However, we, as well as Education's management, recognize that the Department still faces major challenges in correcting systemic financial management problems. A sustained effort will be critical to sound financial management and reliable financial information becoming routine at Education.

## Summary of Results

GAO and Education's Office of the Inspector General (OIG) jointly performed the fiscal year 1993 audit. Due to the limited amount of time between the fiscal years 1993 and 1992 audits and the severity of the long-standing financial management problems, many of the financial management problems identified during the prior year's audit still exist.

[1] Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Year 1992 (GAO/AIMD-93-04, June 30, 1993).

For these reasons, our opinions on the fiscal year 1993 financial statements, internal controls, and compliance with laws and regulations are essentially the same as GAO's opinions covering fiscal year 1992. Our results are as follows.

- We were unable to express an opinion on whether the fiscal year 1993 (1) Statement of Financial Position, (2) Statement of Operations and Changes in Net Position, and (3) Statement of Budgetary Resources and Actual Expenses were fairly stated because reliable student loan data was not available. The student loan data that was available was generally provided by the guaranty agencies and used by the Department in a model to calculate its costs to be incurred on outstanding guaranteed loans (referred to as liabilities for loan guarantees). The inaccuracies in the data were so pervasive that we could not perform sufficient procedures to conclude whether the FFELP's liabilities for loan guarantees of $14 billion and other related line items were fairly stated as of September 30, 1993. These are the most significant amounts in the FFELP Principal Statements.

  We determined, through detailed audit procedures, that the Statement of Cash Flows presents fairly the cash flows of the FFELP for the fiscal year ended September 30, 1993. However, the Statement of Cash Flows reports only the cash actually received and disbursed by the FFELP. Because of the material internal control weaknesses, detailed in GAO's March 1993 report[2] and current year findings summarized in the Significant Matters section of this report, we were unable to determine if Education received or disbursed the proper amounts.

- In our opinion, internal controls were not properly designed and implemented to effectively safeguard assets and assure that there were no material misstatements in the Principal Statements. However, they were effective in assuring material compliance with budget authority and with significant provisions of selected laws and regulations.

  Ineffective internal controls and unreliable student loan data also affected the reliability of information contained in Education's annual budget submission and the Overview of the Reporting Entity. This information was generally derived from the same sources as the information presented in the Principal Statements. Consequently, the reliability of information presented in the budget and the Overview of the Reporting Entity cannot be reasonably determined.

[2]Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement (GAO/AFMD-93-20, March 16, 1993).

- Our tests for compliance with significant provisions of selected laws and regulations disclosed no material instances of noncompliance. The limited tests we conducted would not necessarily detect all material instances of noncompliance, however, nothing came to our attention in the course of our work to indicate that material noncompliance with such provisions occurred.
- Finally, nothing came to our attention to indicate that Education's report on internal controls prepared under the Federal Managers' Financial Integrity Act of 1982 conflicts materially with the results of our evaluation of the internal controls.

## Mission and Operating Environment

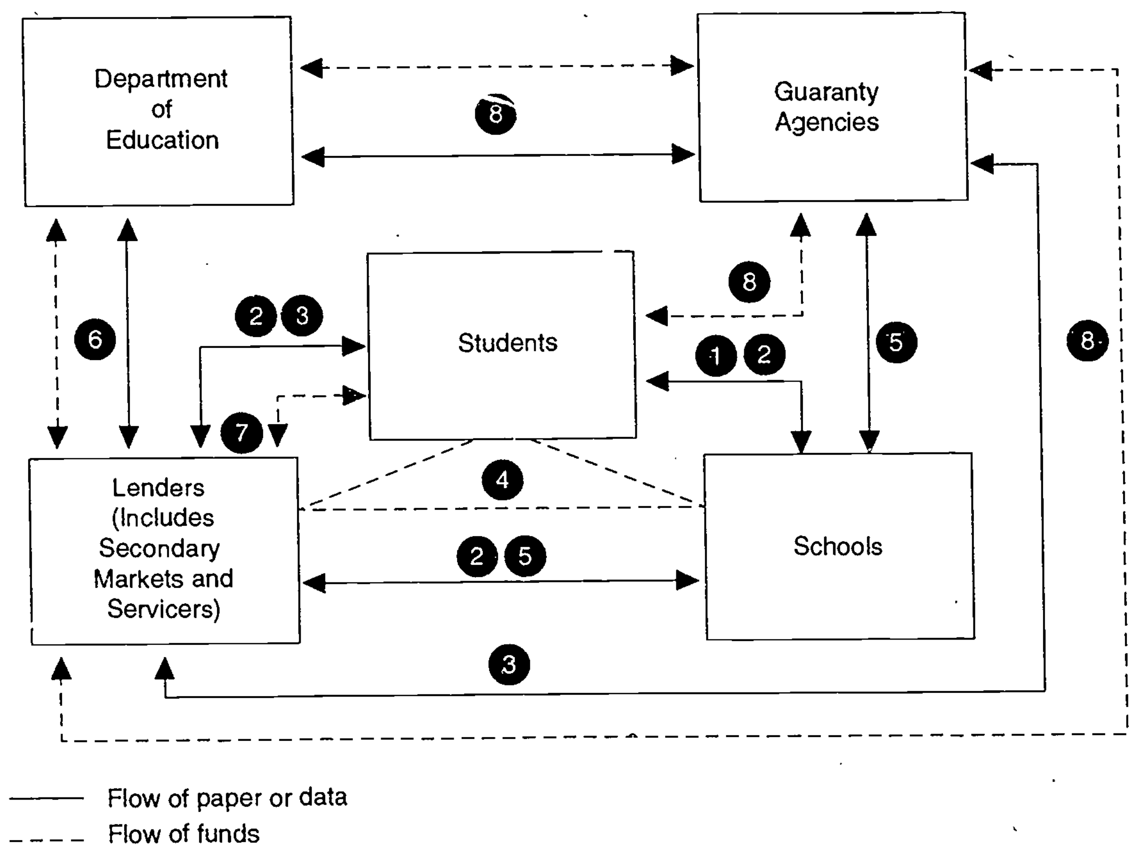
FFELP's primary mission is to increase postsecondary education opportunities for eligible students who otherwise may not be able to further their education. It operates on the premise that once educated, the borrowers will earn income sufficient to repay their loans. Based on this premise, the program's net costs to taxpayers should be minimal. Education needs reliable information to effectively manage this program and to assess the program's performance in achieving its mission.

Established in 1965, the FFELP, formerly known as the Guaranteed Student Loan Program, is the largest postsecondary education loan program of the federal government. At September 30, 1993, Education reported $69 billion in outstanding loan guarantees of which it estimated that $16 billion, net of cancellations, were originated in fiscal year 1993 alone. It also reported paying over $3 billion in 1993 for interest subsidies and special allowances,[3] net of loan origination fees, on certain loans to lenders and loan defaults, net of collections, to guaranty agencies.

The Department relies extensively on schools, lenders, and guaranty agencies in making resources available to eligible students and overseeing this program. It also functions through a complicated and cumbersome set of rules and requirements involving millions of students and thousands of schools, lenders, and other entities. As shown in figure 1, the maze of responsibilities for the delivery structure and processing sequence of a typical loan is complex.

[3]Special allowances are subsidies paid to lenders due to below market interest rates on guaranteed loans.

**Figure 1: Federal Family Education Loan Program: a Complicated and Cumbersome Process**




1. Student provides school with financial information and school determines loan eligibility and counsels student.
2. Student generally obtains loan application from lender, fills out his or her portion, and forwards it to school; school completes application and forwards it to lender.
3. Lender provides information to guaranty agency; agency verifies student eligibility and agrees to guarantee loan; lender sends promissory note to student; student returns signed note to lender.
4. Lender issues check to be endorsed by both school and student.
5. School periodically confirms borrower's continued student status.
6. Lender bills the Department of Education for interest subsidy, reports loan origination fees collected, and provides summary information on its guaranteed loan portfolio.
7. Lender bills student when repayment starts, collects payments, and conducts statutory loan collection services if borrower becomes delinquent or in default.
8. Guaranty agency reimburses lender for defaulted loans and receives reinsurance and an administrative costs allowance from the Department. The agency also receives an insurance premium from students. The agency pays the Department a loan reinsurance fee, shares collections on defaulted loans, and provides the Department with summary information of loans it guaranteed.

Education reinsures loans made by lenders to eligible students or their parents in an effort to ensure the availability of private capital. Guaranty agencies reimburse lenders for loans that default and generally recover default payments from the Department. Education also pays an interest subsidy and special allowance to lenders on certain loans. In addition, schools are required to provide information to Education through guaranty agencies on the current status of students participating in the program.

As a result of this relationship, Education depends on the guaranty agencies and lenders for accurate data in order for it to assess and achieve its program mission. The program's success is directly affected by Education's relationship with and oversight of the 46 active guaranty agencies, approximately 8,000 lenders, and over 7,500 schools.

The federal government's risk of incurring substantial program costs has increased greatly as this program has expanded and evolved. The original plan was for a simple program involving unsubsidized loans that did not require testing for financial need and relied on states to guarantee the loans. This approach fell apart almost immediately because many states were reluctant to establish guaranty agencies. The program was replaced by the present system of interest subsidies, special allowances, and federal guarantees.

The FFELP has been on GAO's and the Office of Management and Budget's (OMB) list of high-risk programs since each agency began this designation in fiscal year 1990. This designation is primarily attributable to (1) the Department's long-standing financial and program management problems, (2) the statutory complexity of the program, and (3) the significant costs incurred by the federal government for loans that default. As of September 30, 1993, the Department has paid, on a cumulative basis from the inception of this program in 1965, default costs[4] totaling $21.5 billion and has guaranteed over $145 billion, net of cancellations, in student loans.

As GAO reported in its fiscal year 1992 report on the FFELP's internal controls, the guaranty agencies' role in this program is essentially that of a fiscal intermediary for the Department. Education is required by law to rely on the guaranty agencies to carry out significant activities of the FFELP. However, its relationship with these guaranty agencies is not structured to give Education sufficient leverage to improve aspects of the program affected by guaranty agency operations. For example, almost all of the

[4]The amount of default claims paid does not include death, disability, or bankruptcy claims.

economic risk associated with guaranteeing student loans under the FFELP is borne by the federal government. At the same time, Education is restricted by law from directly guaranteeing loans made by lenders in a state or region where a guaranty agency is operating. Because of these conditions, traditional business incentives do not govern Education's relationship with guaranty agencies.

Some of the changes made to this program as part of the Higher Education Amendments of 1992 and the Student Loan Reform Act of 1993 may provide Education with additional leverage to manage this program. For example, the Secretary is explicitly authorized to terminate guaranty agency agreements if the Secretary determines that such action is necessary to protect the federal fiscal interest. Moreover, the Secretary is authorized to take certain actions to recover or preserve reserve funds, or assets purchased with reserve funds, held by guaranty agencies. Also, guaranty agencies may be subject to criminal penalties for violating directions of the Secretary in this area.

In addition, the Student Loan Reform Act of 1993 requires the phase in of the Federal Direct Student Loan Program starting in July 1994. Under this program, the Department will make loans directly to borrowers through their participating schools. As a result, Education officials believe that the Federal Direct Student Loan Program should decrease the number of guaranty agencies and lenders involved in the FFELP over the next 5 years. Also, Education expects the Federal Direct Student Loan Program to streamline the student aid process, reduce costs for students, and provide new repayment options which could reduce future defaults. The following table shows the phase-in plan for this new program.

**Table 1: Transition Period for Federal Direct Student Loan Program**

| Academic year | Percentage of new loan volume |
|---|---|
| 1994-1995 | 5 |
| 1995-1996 | 40 |
| 1996-1997 | at least 50 |
| 1997-1998 | at least 50 |
| 1998-1999 | at least 60 |

Like the current program, sound financial management will be critical to the new direct student loan program for assessing performance and program costs. The strong internal controls that are central to good financial management will also help ensure that eligible students continue

to have access to loans and that student and taxpayer interests are protected.

The following section of this report identifies the material weaknesses that Education will need to rectify in order to strengthen financial management and discusses the impact of these weaknesses on the reliability of the information reported in the Principal Statements. Substantial improvements are necessary in each of these areas in order for Education to develop and maintain the necessary sound financial management structure needed to manage its activities.

## Significant Matters

We found that the Department had material weaknesses in internal controls over (1) estimating costs to be incurred on outstanding guaranteed loans (referred to as liabilities for loan guarantees), (2) assuring that billing reports from guaranty agencies and lenders were accurate and that guaranty agencies and lenders reported all default collections and origination fees, respectively, owed to the Department, and (3) preparing accurate financial statements.

During our audit, we noted that the Department continues to be unable to ensure that loan data on participants in the FFELP is accurate. As a result, estimates of liabilities for loan guarantees based on such data are unreliable as well. We continued to find that Education does not have systems or procedures in place to ensure that billions of dollars in payments made to guaranty agencies and lenders were reasonable. We also found that fundamental accounting procedures and system controls were not in place to ensure that financial statements and other management reports were correct. The Department has several corrective actions underway including the development of accounting systems and guaranty agency and lender audit guidelines that, if successful, should significantly improve its financial management.

As a result of the Department's financial management problems related to the FFELP, (1) the cost to the taxpayers for administering the program cannot be accurately determined, (2) additional costs may be incurred as a result of unverified payments made to guaranty agencies and lenders, (3) management, the Congress, and other users of reported information are making financial and operating decisions based on unreliable information, and (4) the Department cannot effectively ensure that only loans to eligible students are guaranteed. These material weaknesses in internal controls continue to impede Education's ability to effectively

manage the FFELP. The Department expects that the National Student Loan Data System will help it address these problems.

## Unreliable Loan Data Continues to Prevent Reasonable Estimates of Costs

As of September 30, 1993, the Department reported liabilities for loan guarantees of $14 billion. In addition, $2.6 billion for program costs was included in the fiscal year 1993 budget. It is essential that the Department have accurate student loan data in order to (1) estimate costs to be incurred on outstanding guaranteed loans, (2) manage loan defaults, and (3) assess its performance in ensuring that loans are available to eligible students.

However, Education developed its estimate of loan guarantees and annual program costs using a model based on an analysis of historical loan data which was not reliable. Due to the number of entities involved in providing information used in developing these estimates and the range of errors we found, it was not practical to determine the potential magnitude of such errors and their effect on the FFELP's liabilities for loan guarantees as of September 30, 1993, or their effect on program costs submitted in the annual budget process. Because of the data integrity problems identified by both us and the Department, there is no way of knowing, at this time, the potential misstatement to the financial and budgetary cost estimates.

The internal control weaknesses we identified were caused largely by the structure of this program, which sometimes limits Education's practical ability to require guaranty agencies to correct the student loan data errors that they have submitted. Some of the recent changes made to this program, as previously discussed, may provide the Department with additional leverage to manage this program.

Examples of the specific student loan data inaccuracies we found are described below.

- For 35 percent of the 662 borrowers we randomly tested and found on Education's annual tape extract[5] of student loan data, guaranty agencies had inaccurately submitted information to the Department. For example, 229 of the 662 had incorrect amounts reported in the data field for "claims principal paid to lender." Twenty-two of these 229 cases had zero recorded in that data field, even though Education had paid a default claim. This data is a key factor in determining the costs of outstanding guaranteed

[5]Guaranty agencies submit annually to Education tape extracts or "dumps" of selected information. Education uses this data for a variety of analyses, including financial and budgetary estimates.

loans. Some guaranty agency officials told us that Education's guidelines are vague as to what information should be submitted by the guaranty agencies. For instance, Education's guidance as to what should be submitted by guaranty agencies as "claims principal paid to lender" and "default outstanding" does not clearly differentiate as to what should be reported.

- The Department's tape extract reviews performed between March 1992 and January 1993 of 33 guaranty agencies identified similar problems with accuracy. As GAO noted in its audit of the fiscal year 1992 financial statements, Education found that the "date-entered-repayment" data field was incorrect for all 130 files it reviewed at one of the largest guaranty agencies. The Department also found discrepancies in the "date-entered-repayment" data field at 25 other guaranty agencies. In addition, discrepancies were found by Education in another key data field, "enrollment-status-code," at 27 of the 33 guaranty agencies reviewed.

  Both of these data elements are important in developing loan subsidy estimates for financial reports. Education found that inaccuracies occurred because some guaranty agencies were not using current loan status data received from the lenders or schools and, instead, were recording estimates for certain data elements. Several of the guaranty agencies we visited stated that they are trying to correct the data errors. However, due to its time constraints, Education has not yet followed up on the status of corrective actions at each agency.

- Some of the data on the tape extract was clearly wrong, such as borrowers defaulting[6] prior to the date that the loans were made and loans made prior to the initiation of this program in 1965. In addition, 13 of the 725 borrowers we tested at the guaranty agencies were missing from the tape extract. While the percentages of these errors were small, they further demonstrate the unreliability of this data.

In addition to the above problems, the tape extract used by the Department consists of data that is at least 6 to 9 months old and is only updated on an annual basis. Also, we found that guaranty agencies made little effort to verify the accuracy of tape extract information before it was submitted to Education. For fiscal year 1993, only 23 of the 46 guaranty agencies' tape submissions were accepted by Education when first submitted.

[6]The default date was determined by using the loan status date for all loans in default. The loan status date should be representative of the date in which the default (that is, last action) occurred.

As a result of these problems, Education has worked more closely with the guaranty agencies in trying to understand and resolve some of the student loan data errors. In addition, the Department is continuing to develop the National Student Loan Data System. It plans to have this system updated weekly or monthly and use it to prevent borrowers who have defaulted on loans or reached maximum award levels from receiving additional loans. The Department currently expects to implement the first phase of the system in September 1994, at which time guaranty agencies' submission of tape extracts will no longer be required. The National Student Loan Data System is expected to be fully operational in May or June 1995.

The Department reported in its Federal Managers' Financial Integrity Act Report for fiscal year 1993 that it expects to save $300 million per year in inappropriate awards being made when this system is fully operational. However, Department officials informed us that some of these savings are already being realized through interim efforts to match student financial aid applicants to defaulters on the annual tape extract. A significant benefit of the National Student Loan Data System will be that more current default data would be available and that it would assist the Department in ensuring that loan limits are not exceeded.

An important factor to the success of the National Student Loan Data System is how guaranty agencies implement systems to provide accurate and timely student loan data to Education. This information will be required at a time when the guaranty agencies' revenue base is declining and the Department is phasing in a direct lending program. Until the National Student Loan Data System is fully operational and the data reliable, decisionmakers—including the Congress—do not have the information necessary to make fully informed decisions about the program.

## Control Weaknesses Result in Billions of Unverified Payments

During fiscal year 1993, the Department paid $1.8 billion to 46 guaranty agencies for loan defaults net of collections and $1.4 billion to approximately 8,000 lenders for interest subsidies and special allowances net of loan origination fees. In order to ensure that guaranty agencies and lenders are paid accurately for defaults, interest subsidies, and special allowances, the Department needs to know that billing reports from the guaranty agencies and lenders are accurate and valid.

However, as reported by GAO in March 1993,[7] Education did not have systems or procedures in place to ensure that individual billing reports submitted by guaranty agencies and lenders were reasonable. In addition, GAO reported that Education and guaranty agencies' external audits were broad in scope and auditors were not required to, and therefore did not conduct, in-depth examinations of the accuracy and validity of guaranty agencies' and lenders' claims for defaulted loans, interest subsidies, and special allowances. As a result, these audits generally did not provide assurance to the Department as to the accuracy of claims submitted or to the adequacy of the guaranty agencies' and lenders' internal controls over such claims.

During our fiscal year 1993 audit, we found that Education continued to pay claims without assurance that the moneys reported on the billing reports were accurate and valid. We found that it did not reasonably ensure that:

- collections from defaulted loans that offset default payments to guaranty agencies were reported timely,
- loan origination fees that reduce interest subsidy and special allowance payments to lenders were reported, and
- default reimbursements, administrative cost allowances, interest subsidies, and special allowances paid to guaranty agencies and lenders totaling billions of dollars were proper.

Highlights of these findings follow.

## Default Collections

During fiscal years 1993 and 1992, guaranty agencies did not report, within the required reporting time[8] $111 million and $133 million, respectively, of offsetting cash collections. We found that on one or more monthly reports submitted during this 2-year period, about 30 of the 46 guaranty agencies reported cash collections totaling $14 million to the Department at least 6 months after the guaranty agencies received the money. This resulted in payments to the guaranty agencies in amounts greater than should have been paid, since offsetting receipts should have been higher than those reported by the guaranty agencies. Several guaranty agencies attributed

[7]Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement (GAO/AFMD-93-20, March 16, 1993).

[8]Education required guaranty agencies to report its share of borrower payments on loan defaults within 60 days of receipt of funds from borrowers. In May 1993, Education notified guaranty agencies that starting July 1, 1993, it would assess interest on such payments not reported 45 days after receipt of funds.

delayed reporting of collections to collection agents not submitting information to them on time. However, it is the responsibility of the guaranty agencies to ensure that necessary information be received so as to meet the Department's reporting requirement. Beginning with billing reports received in July 1993, the Department has assessed interest penalties on guaranty agencies for late reporting of collections.

Of the 16 guaranty agencies we visited, 5 did not reconcile actual cash collections to that reported on their billing reports submitted to Education for reimbursement. In one instance, we found that actual cash collections did not agree with those reported on the billing report, which resulted in the Department paying about $240,000 less than it should have. This error would have been found if reconciliations were performed on actual cash collections to cash collections reported on the billing report. While in this instance an underpayment occurred, this weakness clearly shows that the opportunity for overpayments to occur and go undetected exists.

## Loan Origination Fees

Some lenders were not submitting billing reports to Education promptly, within 90 days after the end of the quarter, as instructed by Education. During fiscal year 1993, lenders were required to report to the Department loan origination fees of 5 percent on most FFELP loans. These origination fees are offset against interest subsidies and special allowances owed to the lenders by Education on the quarterly billing reports. Therefore, a lender may owe the Department money if origination fees are great enough. GAO and Education's OIG have each previously reported[9] that lenders were not submitting loan origination fees to Education promptly. We continued to find that delays were common. For example, 2,027 of the 10,962 lender billing reports received for the quarter ended September 30, 1993, were not submitted within a 90-day time frame, and 1,426 of these had not been submitted after 180 days.

In addition, as GAO reported in its March 1993 report, the Department continues to be unable to determine whether origination fees are received from lenders when loans are sold. Lenders sometimes sell loans before paying the related origination fees, and Education's regulations provide that either the seller or the buyer can pay the fee.[10] Lender billing reports

[9]Stafford Student Loans: Prompt Payment of Origination Fees Could Reduce Costs (GAO/HRD-92-61, July 24, 1992). Proposed Procedure to Ensure Payment of Loan Origination Fees for Stafford Loans (OIG MIR No. 90-10).

[10]Education's regulations also provide that the originating lender and any subsequent holder are jointly and severally liable for payment of the origination fee on the loan.

do not contain detailed information on individual loans, and lenders are not required to inform the Department as to who is paying the fee for a particular loan. We found that total reported loans sold differed from total reported loans purchased for the first three quarters of fiscal year 1993, by amounts ranging from $295 million to $671 million, and that Education had not investigated or reconciled the differences because the system cannot track individual loan sales and purchases. As a result, it did not have the information needed to detect the nonpayment of origination fees when loans were sold.

The Department is currently completing a pilot study to determine the magnitude of unreported origination fees due from lenders. This study is being performed in one region of the country. Preliminary results of this study found that small- to medium-size lenders continue to sell their loans quickly with no incentive to report the loan origination fees to Education. An Education official working on this study believes that these billing reports are not being submitted because the lenders might owe more in origination fees to the Department than the amount it is owed for interest subsidies and special allowances—a billing report would show that the lenders owed Education money.

From this limited study, Education found that hundreds of thousands of dollars are potentially owed to the Department. In an effort to identify and collect origination fees from lenders who have not filed quarterly billing reports, the Department is planning to expand this effort nationwide. We believe that the Department may be losing significant amounts of loan origination fees owed by lenders.

In addition, the Department has a quality improvement team reviewing ways to improve controls over the collection of loan origination fees. The team is analyzing the 1993 tape extract to identify lenders who originated loans in 1993 but failed to report origination fees to Education. The Department plans to give the lenders opportunities to confirm whether the fees have been paid. If a lender fails to respond, Education plans to notify the lender and guaranty agency that the Department has cancelled reinsurance on the loans in question. Education officials informed us that after establishment of the National Student Loan Data System, their ability to track individual loans on a more timely basis will greatly improve.

## Interest Subsidies

The Department was paying interest subsidies on some loans that could have been ineligible for this subsidy. On certain loans, Education is

responsible for paying interest subsidies to lenders as long as the student is in school and during authorized grace and deferment periods. Once a loan enters repayment status, the Department is no longer responsible for paying these interest subsidies. Federal regulations require that guaranty agencies establish procedures for monitoring the enrollment status of students participating in this program. Guaranty agencies must obtain enrollment status information from schools semiannually. They must report to the current holder of the loan, generally a lender, within 60 days any change in status that triggers the beginning of the borrower's grace period or the beginning or resumption of the borrower's immediate obligation to make scheduled payments.

We found that 43 of the 595 student loan accounts that we tested at selected lenders had inaccurate loan statuses based on information provided to us from schools. Twenty-six of the 43 had not been eligible for interest subsidies for more than 6 months according to information that we received from schools; however, the lenders had continued to bill Education for payment during this time. In one case, even though a student had left school in March 1992, interest subsidy payments were included on a March 1993 billing report to the Department. Prior to our identifying these cases, the lenders were unaware that some of these loans were ineligible for interest payments. We also found 9 cases in which interest subsidies were charged to Education, but the schools, identified to us by the lenders, had no record of the students' enrollment during that reporting period.

## External Audits

Each of the 16 guaranty agencies we visited had their fiscal year 1992 and 1993 financial statements audited by external auditors. However, after speaking with the auditors and reviewing their working papers, we found that these efforts focused on broad objectives of determining whether financial statement balances were fairly and reasonably presented. While these audits appeared to have been performed in accordance with applicable standards, Education had not yet issued specific audit guidelines addressing the accuracy of billings for external audits of guaranty agencies. As such, the auditors conducted only limited tests of the accuracy of the billing reports of the guaranty agencies. For example, in testing the agencies' receivables from Education for loan defaults, the external auditors generally verified that the receivable balances were fairly presented based on the agencies' cash collections from Education. These audits did not test whether Education's payments to the guaranty agencies were reasonable. As a result, the Department continues to have little

assurance that bills it pays are correct. This issue was discussed in more detail in GAO's March 1993 report.

Recognizing the necessity for verifying the accuracy and validity of moneys paid to guaranty agencies and lenders and the impracticality of performing assurance procedures themselves, the Department is developing a guaranty agency audit guide and a lender audit guide that would require external auditors to determine whether claims for payments submitted to Education are reasonable. Without such a control, the federal government has increased risk of paying incorrect amounts for loan defaults, interest subsidies, and special allowances, losing revenue, and guaranteeing loans to ineligible students.

## Financial Reporting Internal Control Weaknesses Persist

To ensure that reliable and meaningful information is developed for the Department's management and the Congress to use as a basis for making decisions, a number of basic internal controls need to be in place, such as reconciliations, which ensure that transactions posted to accounting records are properly supported and system change controls which ensure that unauthorized system changes cannot be made. Such controls are designed to ensure the integrity and accuracy of financial information decisionmakers rely on to manage the program.

Although the Office of the Chief Financial Officer (OCFO) and the Office of Postsecondary Education (OPE) have made improvements in financial reporting for the FFELP, Education's financial reporting process[11] continues to be inadequate. As a result, management cannot ensure that the financial statements and other management reports are reliable.

Weaknesses identified during the fiscal year 1993 FFELP financial audit were similar to those identified during the audit for fiscal year 1992 and primarily resulted from

- the general ledger being antiquated and inefficient,
- permanent subsidiary ledgers not established and maintained for FFELP activities, and
- general controls over information and accounting systems not functioning as designed.

[11]This financial reporting process includes analyzing, evaluating, summarizing, reconciling, adjusting, and reclassifying information so that it may be reported to management and/or outsiders. Accounting and information systems supporting the FFELP are an integral part of this process.

Education is redesigning its financial management system. This project is expected to result in an integrated financial management system and to be phased in over a 3-year period beginning in fiscal year 1995. If successful, this system should be instrumental in assisting the Department in addressing the financial reporting problems we found. Specifically, we found the following.

- Education's general ledger system was unable to directly produce the FFELP financial statements because it was outdated and was designed primarily for funds control. As a result, the Department's management had to develop alternative approaches, including the purchase of an additional software package and the use of contracted services, to create these statements and to enable it to prepare agencywide statements in the near future.
- As a result of GAO's recommendations reported in March 1993, the Department established interim subsidiary ledgers for the FFELP. However, these interim subsidiary ledgers did not include all activity affecting loan receivable balances because of their inability to record adjusting entries and were not considered by the Department to be permanent subsidiary ledgers. Therefore, reconciliations were not performed between the general ledger balances and the interim subsidiary ledger balances. The Department did, however, perform monthly reconciliations of general ledger activity and interim subsidiary ledger activity to activity reported in the FFELP information systems. Although these reconciliations should ensure that all activity recorded in the FFELP information systems were recorded in the general ledger and interim subsidiary ledgers, they do not ensure that loans receivable balances reported in the financial statements are complete and accurate.

  The loans receivable balances represent default claims paid that have not been collected or written off. Education's accounting policy is to record this receivable net of amounts not expected to be collected as an offset to its liability for loan guarantees. In order for the Department to know what moneys are owed as well as whether all moneys owed are being collected and reported, it is critical that subsidiary ledgers be established, maintained, and reconciled to the general ledger. The Department is currently enhancing the subsidiary ledger process to enable the interim subsidiary ledgers to record adjusting entries. In addition, it has initiated a task order to develop permanent subsidiary ledgers which should be operational in fiscal year 1996.

- At the time of our review, Education did not have effective general controls[12] over information systems to safeguard assets, maintain the confidentiality of student loan data, and ensure the reliability of financial management information. We found that (1) controls over access to data and computer programs were ineffective, (2) computer security administration needed strengthening, (3) system software change controls were inadequate, and (4) computer disaster recovery plan testing and evaluation procedures were insufficient.

  To address these weaknesses, the Department and its contractor have taken corrective actions such as (1) reducing system software programmers' access to FFELP data by approximately one-third, (2) developing a system to monitor activities of personnel with broad-based or privileged access to FFELP data, and (3) enhancing the disaster recovery program. In addition, the Department is establishing formal policies and procedures for security administration functions and expects to complete this project by September 1994.

- Likewise, the general controls over Education's general ledger system did not adequately restrict access to data files, computer programs, and system software. Security responsibility is spread out, with no one person having responsibility for the overall system. This has resulted in gaps in security oversight. For example, we found that (1) weaknesses identified in prior general ledger security reviews had not been corrected, (2) two of eight system administrators still had access to the system after they were no longer employed with the Department or by its contractor, (3) an audit trail on user activities was not properly maintained, and (4) passwords were not changed unless requested by the users. Based on our discussions with Education officials, no one had clear responsibility for oversight of overall system security. This responsibility would include oversight of system administrators, who, among other job functions, created and distributed user passwords. In addition, we found that staff assigned to manage this system had limited or no security training. Also, the disaster recovery plan had not been finalized or tested for the general ledger system. As a result of these weaknesses, unauthorized changes and access to data files, computer programs, and system software could occur within the general ledger system without detection.

[12]General controls over accounting and information systems include reviewing changes to application and system software, system development design practices, segregation of duties, telecommunications, disaster recovery and contingency planning, and data security.

## Other Matters

In addition to the material internal control weaknesses just discussed, other matters came to our attention during the audit that we felt should be highlighted within this report. These matters included concerns about (1) Chief Financial Officer (CFO) responsibilities, (2) budget formulation, (3) other program cost estimation issues, and (4) the Federal Direct Student Loan Program. We believe that each of these areas offers opportunities for the Department to significantly improve its internal controls and financial management of this program.

## CFO Organizational Structure

Education's current organizational structure could make it difficult for the CFO to effectively perform certain responsibilities under the Chief Financial Officers Act of 1990. The CFO Act and OMB's February 1991 implementing guidance to agencies on preparing CFO organizational plans outline the agency CFO's authority and role in improving the agency's organizational structure and systems. Specifically, under the act and OMB's guidance, the agency CFO's responsibilities include, among other things, (1) overseeing all financial management activities relating to the programs and operations of the agency, (2) developing and maintaining an integrated agency accounting and financial management system, including financial reporting and internal controls, and (3) directing, managing, and providing policy guidance and oversight of the development of agency financial management budgets. Education's CFO structure could limit the CFO's ability to carry out these responsibilities effectively because budget functions and program financial management and related systems are not direct responsibilities of the CFO.

Prior to August 1993, Education's CFO had responsibility for budget functions. At that time an organizational change occurred and the Secretary reported to OMB that the CFO should not be responsible for the budget functions because (1) the budget and evaluations functions are integral elements of the Department's process for formulating policy and should be closely coordinated under the responsibilities of the Under Secretary and (2) the CFO would have to focus more on budget matters than on important financial management matters and on integrating the Department's financial information systems. The Secretary informed GAO that the Department believes that the current organizational structure should ensure greater attention to financial management issues than under the old organization where these matters were often overshadowed by budget concerns.

We are concerned, however, that the lack of these budget responsibilities for (1) budget functions and (2) program financial management and related systems that feed into the general ledger could make it difficult for the CFO to effectively support good financial management, including the development and maintenance of integrated accounting and financial management systems and the reporting of complete, reliable, consistent, and timely information.

In our view, the ideal situation would be that the CFO have direct input into an agency's annual budget process, the ability to review the validity of estimates made and the reliability of the assumptions used, and sign-off authority before formal budget submissions are made. A review of the CFO organization functions for the 23 agencies covered by the act shows that 20 CFOs are responsible for budget formulation and execution. Education is only 1 of 3 agencies covered by the act whose CFO does not have these responsibilities.

We believe it is important that the Department continue to monitor the effectiveness of its current structure to ensure that the objectives of the CFO Act are met. We also believe it is important that the Under Secretary and the Assistant Secretary for Postsecondary Education continue to work closely with the CFO in supporting good financial management and ensuring that the CFO is able to effectively perform certain responsibilities under the act.

## Budget Formulation Concerns

The estimate of FFELP's program costs continues to be a major budget formulation concern. As GAO reported in the fiscal year 1992 financial audit of FFELP, Education's estimates of FFELP's costs, which are incorporated in Education's annual budget submission, were derived using the same unreliable data and internal control deficiencies as its liabilities for loan guarantees. Because there is no evidence, as demonstrated from our fiscal year 1993 FFELP financial audit, that this condition has significantly improved, the accuracy of projected program costs continues to be questionable.

For example, Education estimated that for certain types of loans guaranteed in fiscal year 1993, it would pay an interest subsidy in that year for 89 percent of borrowers receiving subsidized loans. However, upon subsequent analyses and discussion with the Congressional Budget Office, Education determined that in fiscal year 1993 it would most likely pay an interest subsidy for 98 percent of those borrowers. Primarily, as a result of

this change, Education's estimate for the cost of loans guaranteed in fiscal year 1993 was increased by $476 million. For fiscal years 1994 and 1995, Education's model was adjusted to reflect more realistic percentages of students for which interest subsidies would be made.

In addition, Education continued to use some assumptions in its model for estimating program costs which were more optimistic than historical data adjusted for program changes would support. Specifically, we found that assumptions were overly optimistic related to (1) the percentage of loans estimated to default in the future and (2) future interest rates.

First, Education assumed a lower than adjusted historical default rate. It used 15 percent as a projected default rate while, based on adjusted historical data, we believe that 20 percent should have been used. As reported in GAO's fiscal year 1992 financial audit of FFELP, Education continued to base its assumed lower default rate on legislation and program initiatives designed to reduce defaults. Although such legislation and program initiatives should result in lower default rates, we found no basis to support the level of change that Education had projected (a 25 percent reduction in defaults as compared to adjusted historical data).

Recognizing that the underlying data itself is questionable, we recalculated the FFELP projected loan defaults using what we believe to be a more realistic rate. Our rate was developed by reviewing the program's historical trends at Education and guaranty agencies. We also made adjustments for anticipated improvements due to the legislation referred to earlier. These adjustments were significantly less than Education's because the default reduction tool, which eliminates schools with high default rates, has not yet proven to have as significant of an effect on default rates as Education had projected. In addition, we believe that other recent legislation, including allowing more students to receive loans and increasing loan limits, could result in increased defaults in the future.

Considering our recalculated default rate, Education's estimate of the cost to taxpayers for loans guaranteed in fiscal years 1994 and 1995 could be understated by as much as $800 million. Education expects to guarantee about $18.2 and $15.2 billion in loans in fiscal years 1994 and 1995, respectively. The President's budget included estimated costs[13] of $2.3 billion and $1.8 billion for new loan guarantees in those respective years. Using what we believe to be a more realistic default rate, but the

[13]In accordance with the Federal Credit Reform Act of 1990, the cost included in the budget represents the net present value of expected future cash flows.

same underlying data used by Education, the cost to taxpayers for these loans could be as high as $2.6 billion and $2.3 billion for fiscal years 1994 and 1995, respectively.

Secondly, Education's model was also optimistic as to projected interest rates. Education estimated, based on 6-year interest rate projections provided by OMB, that no special allowance would have to be paid over the next 16 years for loans guaranteed in fiscal years 1993 through 1995. Its budget estimates relating to such loans could be significantly understated. We question Education's assumption regarding special allowances due to the inherent uncertainty associated with interest rates over such a long period of time.

Education's continued use of these optimistic assumptions could affect the usefulness of its program cost estimates to those making program decisions as well as require substantial use in future years of the permanent indefinite budget authority provided for reestimates under the Federal Credit Reform Act of 1990.[14] The Department has initiated efforts to have a contractor review some of its loan model assumptions. It plans to make any needed changes to its assumptions based on the results of this review, which is expected to be completed during the summer of 1994.

It is very important to note that because budgeted program costs were derived using the same unreliable data and internal control deficiencies as Education's liabilities for loan guarantees, there is simply no way of knowing at this time the full range of error for the potential misstatement of Education's budget estimates for loans guaranteed in fiscal years 1993 through 1995.

## Other Program Cost Estimation Issues

In fiscal year 1993, Education was unable to follow OMB's guidance to estimate and reestimate program costs because three of the largest guaranty agencies did not provide necessary loan data. OMB Circular A-11 contains what OMB characterizes as instructions and guidance for agency use in estimating and reestimating credit program costs under the Federal Credit Reform Act of 1990. Using these instructions, agencies would have to categorize each outstanding loan guarantee and separately estimate, or reestimate, the costs of loan guarantees in each category. Since Education determined that collecting data on an individual loan level would have been extremely burdensome to its program participants, OMB agreed that

[14]The Federal Credit Reform Act of 1990 changed the budget treatment of loans and loan guarantees made on or after October 1, 1991, to more accurately reflect the cost to the government.

Education could estimate and reestimate costs of loan guarantees using a random sample of guaranteed loans in the FFELP portfolio.

However, 3 of the largest guaranty agencies, from which Education had planned to obtain more than half of the sample records, did not provide these records to Education. Further, as a result of the relationship between Education and the guaranty agencies discussed earlier, Education's subsequent attempts to obtain the sample records from these guaranty agencies were unsuccessful. Accordingly, Education was unable to estimate and reestimate program costs in the manner agreed to by OMB. Instead, Education relied on the tape extract data, which as discussed earlier was highly questionable, to develop estimates and reestimates of program costs as it had in the past.

As previously mentioned, the Department is dependent on the guaranty agencies to provide timely and accurate loan information. However, as evidenced by the Department's experience relating to loan estimates and reestimates, its practical ability to require that accurate and timely data be submitted is limited.

## Federal Direct Student Loan Program

The Federal Direct Student Loan Program (FDSLP) is expected to save taxpayers billions of dollars and substantially improve the student loan process. The successful implementation of this program will be critical to ensuring continued loan access to eligible students as the FFELP is phased down over the next 5 years.

Education expects the FDSLP to streamline the student aid process, reduce costs for students, and provide new repayment options which could reduce future defaults. Education also expects to save taxpayers an estimated $4.3 billion primarily by (1) the reduction of interest subsidies to lenders, (2) the reduction in payments to guaranty agencies and lenders participating in the FFELP as the FDSLP is phased in over the next 5 years, and (3) new savings introduced to the FFELP through additional fees. The Department believes that part of these substantial savings will be used to reduce interest rates for student borrowers when the program is fully implemented.

Since August 1993, Education has made progress in implementing the FDSLP. For example, the Department reported that it selected participating schools for the 1994-1995 academic year 6 weeks ahead of its schedule,

published regulations on time, and awarded the contract for origination and servicing of direct loans on schedule.

As the program gets underway, Education officials believe that the future loan volume and current profit margins of guaranty agency businesses will be reduced, causing some of the current 46 active guaranty agencies to withdraw from the FFELP. In an effort to ensure continued loan access under the FFELP and a smooth transition to direct lending, Education contracted with a private nonprofit agency, Transition Guaranty Agency, to perform, as a last resort, guaranty agency functions of servicing outstanding loan portfolios and providing new guarantees. In addition, Education has negotiated an agreement with the Student Loan Marketing Association (Sallie Mae) to assume responsibilities as a "lender of last resort."[15] With these agreements in place, the Secretary believes that every eligible student can continue to have access to loans.

Education is under pressure to meet tight statutory deadlines for implementing the program and gaining needed school participation and support. In addition, loan volume is supposed to increase by 700 percent in the second year of operation (from 5 percent of the Department's current loan volume to 40 percent in the second year) and increase further still in future years (see table 1). As a result, we believe the Department faces a significant challenge of ensuring that these pressures do not prevent it from implementing the necessary internal controls as the FDSLP is phased in and the FFELP is phased down.

## Conclusions

The Department of Education faces many challenges in addressing its long-standing financial management problems, most important of which is correcting the numerous data integrity problems underlying the financial management systems. The problems we identified are not ones that lend themselves to "quick fixes" but rather require comprehensive efforts to correct root causes.

In addition to these challenges, there is a continuing need to deal with federal budgetary pressures and the call for government to reinvent itself by managing better with fewer resources. To accomplish this, the Congress, as well as Education's managers, need financial management information that is meaningful and accurate in order to make sound decisions. The need to correct long-standing problems in financial

[15]An entity required to make loans to eligible students who were unable, after conscientious efforts, to obtain funds from other entities. Guaranty agencies are also "lenders of last resort."

operations becomes even more critical as Education starts lending directly to students under the Federal Direct Student Loan Program. Otherwise, the same problems that are affecting Education's guaranteed loan program could also pervade the new direct loan program.

## Recommendations

A summary of the status of GAO's recommendations from the audit of FFELP's fiscal year 1992 financial statements is included in appendix II. While Education made progress during fiscal year 1993 in addressing many of these recommendations, few of these efforts have been completed due to the limited time since the prior year's audit and the severity of the financial management problems. Education expects that several of these recommendations will be addressed through its implementation of the National Student Loan Data System (NSLDS) and the Federal Direct Student Loan Program. We believe that if the improvement efforts are successful they could significantly improve accountability in the FFELP.

We reaffirm all of GAO's previous recommendations included in appendix II that have not yet been completed by the Department. We especially emphasize the need for the Department to continue its efforts to (1) require guaranty agencies to correct data needed as input into the NSLDS, (2) require guaranty agencies and lenders to have external auditors perform procedures to determine whether claims for payments submitted to Education are reasonable, (3) test billing reports as part of the guaranty agencies and lenders internal reviews, (4) develop and maintain subsidiary ledgers for the FFELP, and (5) develop procedures to ensure that the general ledger maintained by OCFO is periodically reconciled to subsidiary ledgers maintained by OPE.

In addition, we continue to suggest that the Congress consider amending the Higher Education Act to require that originating lenders pay loan origination fees even if the loan is subsequently sold to another lender.

As a result of our audit of FFELP's fiscal year 1993 financial statements, we recommend that the Secretary of Education direct the Assistant Secretary for Postsecondary Education to perform periodic analyses to determine whether lenders are submitting billing reports promptly, within 90 days after the end of the quarter, as instructed by Education. These analyses should include follow-up procedures with individual lenders not submitting billing reports promptly.

We also recommend that the Secretary of Education direct the Assistant Secretary for Human Resources and Administration to clearly identify security responsibilities and oversight for Education's general ledger system, including establishing a security officer responsible for the overall security of this system. The security officer's responsibilities should include

- developing and completing action plans to respond to previously reported security weaknesses,
- properly maintaining and reviewing an audit trail of user activities,
- ensuring that former contractors and terminated employees are denied access to the system,
- changing passwords periodically (possibly monthly or quarterly), and
- finalizing and testing a disaster recovery plan for the general ledger system.

In addition, the Assistant Secretary for Human Resources and Administration should require and ensure that security administrators and supporting technical staff, who are responsible for the general ledger system, have security training.

## Agency Comments and Our Evaluation

The Department provided comme. on a draft of this report, which are reprinted in appendix III. In gener , it agreed with our recommendations and plans to determine the best way to proceed to achieve the desired results. With respect to the section of the report that highlights concerns about the CFO organizational structure, however, the Department believes that the current CFO structure enables it to meet all the CFO Act's responsibilities. As stated in this report, we continue to believe that it is important that the Department continue to monitor the effectiveness of its current structure to ensure that the objectives of the CFO Act are met.

In closing, we would like to commend the Department for its second-year effort to develop financial statements. We believe that, although many challenges still remain, the Department's progress to date represents its commitment toward the CFO Act's ultimate goal of improving financial management throughout the federal government.

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May 20, 1994

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## Overview of the Reporting Entity

OVERVIEW OF REPORTING ENTITY

I. BACKGROUND AND MISSION STATEMENT OF THE DEPARTMENT OF EDUCATION'S FEDERAL FAMILY EDUCATION LOAN PROGRAM

The Federal Family Education Loan (FFEL) Program, formerly called the Guaranteed Student Loan Program (GSLP) is the largest provider of financial aid among the Student Financial Assistance Programs administered within the U. S. Department of Education. The table below shows trends in Title IV aid over a 15-year period. In order to control for the effects of inflation, all comparisons are made using constant 1991 dollars.

TITLE IV AID AWARDED TO POSTSECONDARY STUDENTS IN CONSTANT 1991 DOLLARS (IN MILLIONS) SELECTED YEARS

Title IV Programs -- Constant 1991 Dollars(millions)

| Academic Years | FFELP | Pell | Perkins | CWS | SEOG | SSIG | Total |
|---|---|---|---|---|---|---|---|
| 1976-77 | $ 3,076 | $ 3,421 | $ 1,299 | $ 1,012 | $ 566 | $ 101 | $ 9,475 |
| 1981-82 | 10,452 | 3,329 | 840 | 903 | 523 | 113 | 16,160 |
| 1986-87 | 11,151 | 4,216 | 935 | 771 | 489 | 89 | 17,651 |
| 1991-92 | 13,791 | 5,708 | 855 | 771 | 578 | 62 | 21,765 |

FFELP = Federal Family Education Loan Program (formerly Guaranteed Student Loan Program)
Pell = Pell Grant Program
Perkins = Perkins Loan Program
CWS = College Work Study
SEOG = Supplemental Education Opportunity Grant
SSIG = State Student Incentive Grant

Source: All data prior to 1991-92 were obtained from The College Board, Trends in Student Aid: 1982 to 1992 September 1992, pp 5,13. Data for 1991-92 were obtained from U.S. Department of Education data files.

Note: The Consumer Price Index for all urban dwellers (CPI-U) was used to adjust for inflation. Aid is reported by the academic year in which it was awarded. FFEL Program dollar volume represents loan commitments rather than actual amounts loaned. SSIG figures include only the federal portion.

This program, which operates through state and private nonprofit guaranty agencies, makes low-interest, long-term loans available to students attending participating postsecondary schools. Generally, these loans are made by commercial lenders, but some guaranty agencies and schools also participate as lenders in the program. Over $140 billion in loans have been guaranteed as of September 30, 1992 (See Figure 1). Further, we estimate that the outstanding balance of guaranteed loans was $69 billion at September 30, 1993.

The FFEL Program is comprised of the following five loan programs, 1) Federal Stafford Loans, 2) Unsubsidized Federal Stafford Loans, 3) Federal Supplemental Loans for Students (SLS), 4) Federal Parent Loans for Undergraduate Students (PLUS), and 5) Federal Consolidated Loans. These components are generally considered to be separate program entities because each has its own participants, loan limits and loan volume. However, students may participate in more than one program.

The FFEL Program has undergone several changes in the 28 years since its inception in 1965. Some of the most significant changes included requiring all loan applicants to demonstrate need in order to qualify for a federally subsidized loan (formerly only those with adjusted gross family incomes of $30,000 a year or higher were subject to need analysis), increasing annual and aggregate loan limits for all borrowers, providing for unsubsidized Stafford loans for borrowers who do not qualify for federal interest subsidies under the Stafford program, and implementation of the Federal Direct Student Loan Program.

Mission and Goals

The FFEL Program was designed to increase postsecondary education opportunities for eligible students who otherwise may not have been able to further their education. The program operates on the premise that once educated, the borrowers earn income sufficient to repay their loans. In 1991 and 1992 respectively, the program generated about 4.8 million and 5.1 million new loans, totaling over $13.5 billion and $14.7 billion for students attending over 7,500 schools. These loans were provided by approximately 8,000 lenders and administered by 46 state or private nonprofit guaranty agencies participating in the program. The structure of the FFEL Program is dependent on guaranty agencies in helping to meet the mission of the program. As can be seen in figure 2, about 90 percent of the guaranty agencies' revenues are received from the Federal Government.

The FFEL Program supports two key Departmental priorities, which are: 1) to ensure access to a high quality postsecondary education and lifelong learning, and 2) to transform the Department into a high performance organization.

The two key FFEL Program goals supporting these practices are: 1) continuing to administer the programs with integrity, equity and efficiency while continuously improving the quality of service through reinvention strategies identified in the strategic plan; and 2) fostering and promoting an organizational culture supportive of responsive public service, diversity, innovation and continuous improvement.

## II. FINANCIAL RESULTS AND CONDITION

- This section highlights key features of the FFEL Program Financial Statements for the fiscal year ended September 30, 1993.

| NET OPERATING ACTIVITY | |
|---|---|
| 1992 | 1993 |
| ($3,913M) | ($3,296M) |

- The net operating activity improvement reflects increased interest earned on funds deposited with U. S. Treasury and a decrease in the provision for loan defaults and other program expenses.

| NET POSITION | |
|---|---|
| 1992 | 1993 |
| ($12,785M) | ($10,358M) |

- The appropriations received for future outlays were sufficiently greater than the appropriations and subsidies returned and net operating activity to cause the movement in the net position.

| NET CASH FLOWS FROM OPERATIONS | |
|---|---|
| 1992 | 1993 |
| ($3,567M) | ($3,359M) |

- Increased interest income and decreased program expenses are the main factors affecting this indicator.

| TOTAL ASSETS | |
|---|---|
| 1992 | 1993 |
| $4,080M | $5,338M |

- The increase in the fund balance with U. S. Treasury accounts for the increase in total assets.

| TOTAL LIABILITIES | |
|---|---|
| 1992 | 1993 |
| $16,865M | $15,696M |

- The improvement in total liabilities is a result of the decrease in the due to U. S. Treasury.

## III. PROGRAM PERFORMANCE (RESULTS/OUTCOMES)

Since the program's inception the number of loans made annually has increased from about 89,000 to over 5 million in fiscal year 1993; the cumulative loan volume prior to cancellations increased from about $73 million to over $160 billion during this period. Figure 3 documents the change in loan volume for the FFEL Program.

Students attending proprietary institutions were especially dependent on the program. As seen on the table below, approximately 20 percent of the students attending proprietary institutions during the 1989–90 school year received a Stafford loan in relation to approximately 5 percent of all other undergraduate students.

**PERCENTAGE OF UNDERGRADUATE STUDENTS RECEIVING STAFFORD LOANS AND PELL GRANTS BY TYPE OF INSTITUTION ATTENDED 1989–90 ACADEMIC YEAR**

| Type of Institution | Total Undergraduate Students | Total Stafford Loans | Percentage |
|---|---|---|---|
| Public Four Year | 5,260,484 | 326,150 | 6% |
| Private Four Year | 2,297,912 | 335,495 | 15% |
| Public 2 Year | 7,052,280 | 98,732 | 1% |
| Private 2 Year | 269,140 | 23,146 | 9% |
| | 14,879,816 | 783,523 | 5% |
| Proprietary | 1,391,453 | 274,116 | 20% |
| All Institutions | 16,271,269 | 1,057,639 | 7% |

Source: 1989–90 National Postsecondary Student Aid Study (NSPAS) data Files, U.S. Department of Education, Office of Educational Research and Improvement, National Center of Education Statistics.

Notes: Figures include all students who attended during the 12–month period of the 1989–90 academic year, not just those who comprised the official annual enrollment count taken during the fall term.

While the FFEL Program has been successful in providing access to postsecondary education for millions of students, its costs and risks have also increased. Loan defaults increased significantly during the 1980's and have decreased slightly in the past two years.
The factors responsible for the increase in defaulted loans were 1) the increase in the FFEL Program loan volume and 2) the changing characteristics of the program population, especially the increase in loans to proprietary school students. Borrowers attending proprietary schools have a higher default rate than those attending other types of postsecondary institutions. Higher default rates are also associated with students who withdraw rather than graduate, have low adjusted gross incomes, and are financially independent, rather than dependent on their parents.

In addition, the decrease in defaults in the most recent years was due to legislative changes that reduced the number of high default rate schools that were participating in the program.

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Accountability Problems

The Department's Office of Inspector General, the Office of Management and Budget, and GAO reports have documented accountability problems that have contributed to defaults, fraud and mismanagement. One of the most significant problems is that the Department's student loan information systems contain data that are not always useful, timely, or accurate, thereby limiting their use for compliance and evaluation purposes. The Congress and the Department, recognizing the need to strengthen program integrity, have made substantial changes to fix the existing program. For example, on August 10, 1993 the Student Loan Reform Act of 1993 was passed, establishing the Federal Direct Student Loan Program. In addition, the Department is currently developing the National Student Loan Data System, which will provide the Department, for the first time ever, with a centralized database containing detailed information on the universe of student loan borrowers. The system will provide on-line access to the data on a loan-by-loan basis. As a result, the Department should be better able to manage the program by ensuring that (1) loan limits are not exceeded and (2) that students who have previously defaulted are not still receiving loans.

To strengthen the student financial aid "gatekeeping process," we have consolidated our internal responsibility for accreditation, eligibility, and certification functions that determine which schools can participate in these programs. In addition, as a result of the Secretary's efforts to obtain congressional funding approval, we are now implementing the new state postsecondary review program which will increase states' roles in the review and certification of postsecondary institutions.

## IV. ADDITIONAL INFORMATION

Education's Office of Postsecondary Education, prepares the Guaranteed Student Loan Programs Data Book annually. This publication, most recently published in draft form in fiscal year 1992, is a compilation of statistical data, tables and charts for all components of the FFEL Program since its inception in 1965. It is forwarded to Congress, the guaranty agencies, and other interested parties upon request.

Fiscal year 1993 was the second year that the FFEL Program financial statements were issued and audited in accordance with the Chief Financial Officers Act of 1990, and related Office of Management and Budget guidance. Financial data for periods prior to fiscal year 1992, and all statistical data included in this reporting entity overview is unaudited and based solely on the books and records of the Department of Education.

Education has a major initiative underway to develop meaningful performance measures for all programs. The effort is spearheaded by the Monitoring and Performance Measures Team (MPMT), established by the Deputy Secretary. This team consists of executives and managers appointed by appropriate senior officers. The MPMT has initiated a pilot effort with the National Academy of Public Administration (NAPA) in which performance measures are being developed for five specific programs. These will include measures of inputs, outputs, efficiency, effectiveness, and outcomes. NAPA will also produce a handbook to guide performance indicator development for other Education programs.

This effort, which has been designed to produce measures that will have relevance and be useful for planning, managing and controlling Departmental programs, will require several years to complete. In the meantime, the performance indicators presented in this report were derived from existing information, primarily the data book previously discussed and the September 30, 1993, guaranty agency quarterly reports (Education Form 1130), to provide a preliminary view of the FFEL Program's performance.

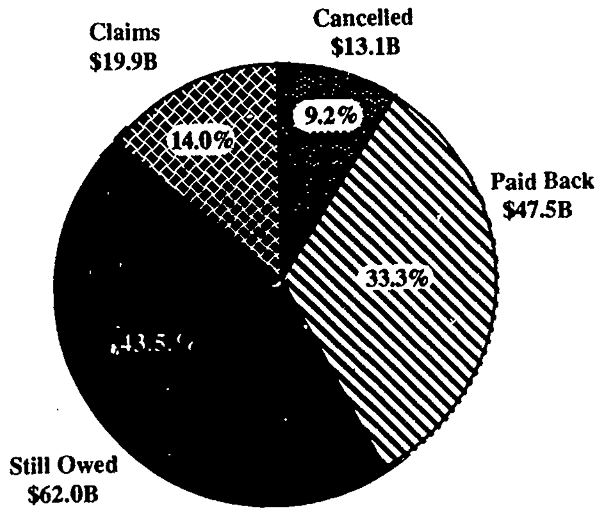
DIRECT STUDENT LOAN PROGRAM

The proposal to phase in a Direct Student Loan Program is at the forefront of initiatives in postsecondary education. It will streamline the process and reduce costs for students; it will provide them new repayment options, including fixed, graduated, extended, and income-contingent plans; and it will save the taxpayers an estimated $4.3 billion primarily by (1) the reduction of interest subsidies to lenders, (2) the reduction in payments to guaranty agencies and lenders participating in the FFELP as the FDSLP is phased in over the next 5 years, and (3) new savings introduced to the FFELP through additional fees.

The Department has already taken many steps to implement the Direct Loan Program on a timely basis. All implementation activities are on schedule, including the publication of regulations, the selection of the first 104 schools, and the awarding of support contracts.

## FFELP PORTFOLIO STATUS AS OF 9/30/92

| | ($ IN BILLIONS) |
|---|---|
| STAFFORD, PLUS, SLS and FISL loans guaranteed (commitments) | 142.217 |
| (-) Loans cancelled | 13.108 |
| (=) Net loans guaranteed | 129.109 |
| (+) HPSL/Perkins loans becoming FFELP's due to consolidation | .245 |
| (=) Total net loans guaranteed | 129.354 |
| (-) Defaults | 19.029 |
| (-) Death, Disability and Bankruptcy | .835 |
| (-) Paid in fulls | 18.700 |
| (-) Installment payments | 28.790 |
| (=) Current principal balance outstanding | 62.000 |
| A. Still in school | 20.134 |
| B. Current principal balance in repayment | 41.866 |

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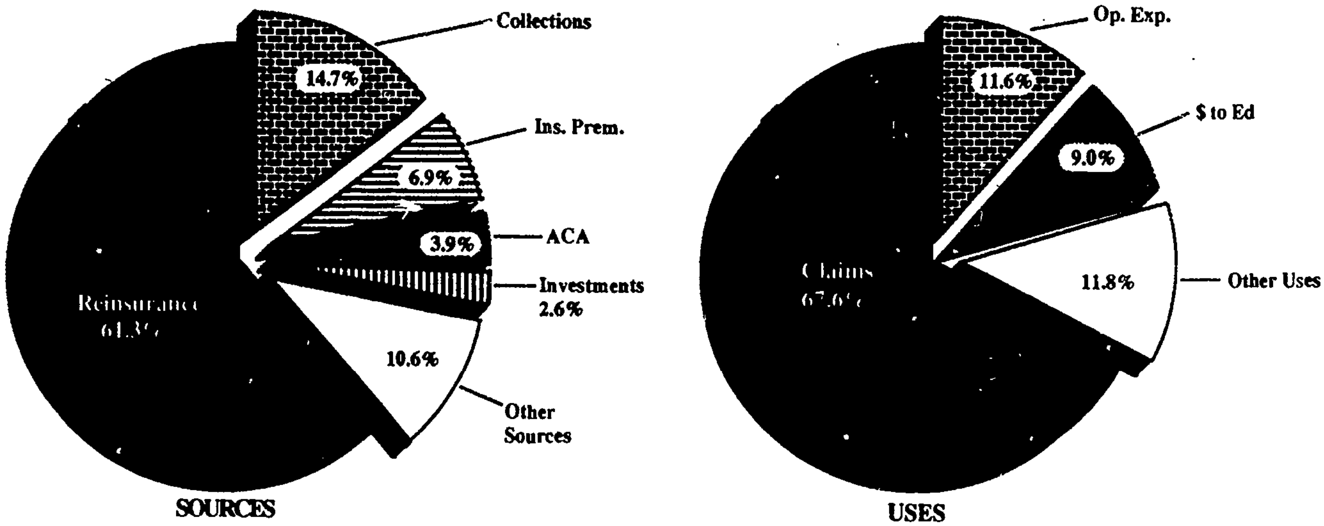
## FFELP GUARANTY AGENCY SOURCES AND USES OF FUNDS CUMULATIVE AS OF 9/30/92




| | | | |
|---|---|---|---|
| Reinsurance | Reinsurance Claims (default, death and disability, or bankruptcy) | Claims | Claims paid to lenders (default, death and disability, or bankruptcy) |
| Collections | Collections on default claims paid | Op. Exp. | Operating Expenses |
| Ins. Prem. | Insurance Premiums | $ to Ed | Portion of collections remitted to Department of Education |
| ACA | Administrative Cost Allowance | | |
| Investments | Investment Earnings | Other Uses | e.g., lender Fees, repayment of loan advances, repayment of state loans, reinsurance fees |
| Other Sources | e.g., State appropriations, advances and other non-Federal sources | | |

**Note: All data reflect cash receipts and disbursements as reported in the Guaranty Agency Quarterly Reports**

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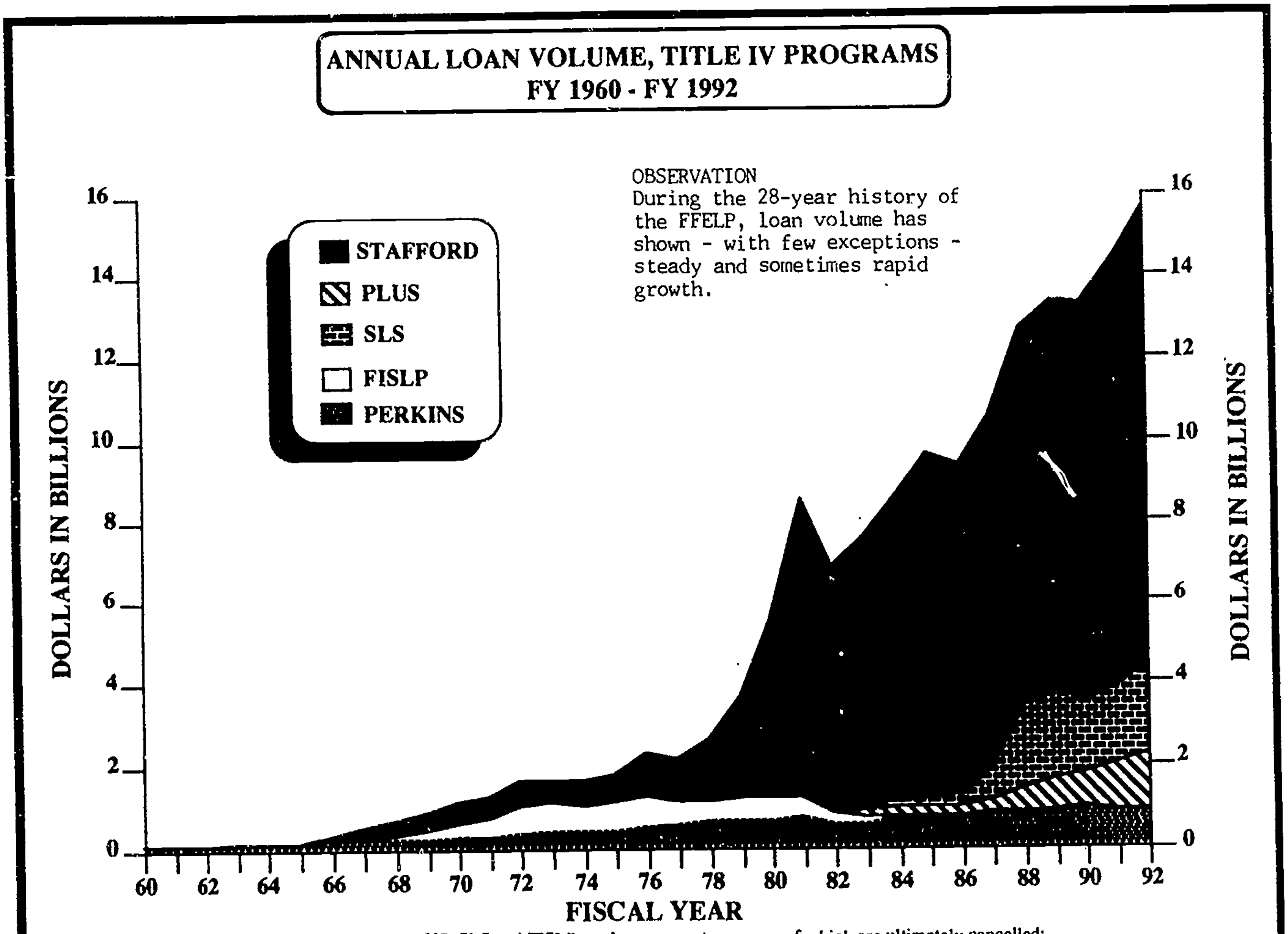


Note: Loan volume for Stafford, PLUS, SLS and FISLP are loan guarantees, some of which are ultimately cancelled; Perkins loan volume refers to actual dollars disbursed.

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## Statements of Financial Position

As of September 30, 1993 and 1992
(Dollars in Thousands)

| | 1993 | 1992 |
|---|---|---|
| **ASSETS** | | |
| **Financial Resources:** | | |
| Fund Balances with U.S. Treasury | $ 5,298,276 | $ 4,023,651 |
| Advances to Guaranty Agencies, Net | 39,767 | 40,803 |
| Accounts Receivable, Net | 0 | 15,541 |
| **Total Assets** | $ 5,338,043 | $ 4,079,995 |
| **LIABILITIES** | | |
| **Liabilities Covered by Budgetary Resources:** | | |
| Liabilities for Loan Guarantees, Short-Term | $ 2,062,863 | $ 1,430,743 |
| Liabilities for Loan Guarantees, Long-Term | 3,233,032 | 1,549,846 |
| Due to U.S. Treasury | 0 | 1,057,960 |
| Accrued Salaries | 2,381 | 643 |
| Total Liabilities Covered by Budgetary Resources | $ 5,298,276 | $ 4,039,192 |
| **Liabilities not Covered by Budgetary Resources:** | | |
| Liabilities for Loan Guarantees, Short-Term | 3,209,929 | 2,996,631 |
| Liabilities for Loan Guarantees, Long-Term | 5,127,419 | 7,737,388 |
| Borrowing from U.S. Treasury | 2,058,407 | 2,090,103 |
| Accrued Compensated Leave | 1,897 | 1,819 |
| Total Liabilities not Covered by Budgetary Resources | 10,397,652 | 12,825,941 |
| **Total Liabilities** | 15,695,928 | 16,865,133 |
| **NET POSITION** | | |
| Invested Capital | 39,767 | 40,803 |
| Future Funding Requirements | (10,397,652) | (12,825,941) |
| Total Net Position | (10,357,885) | (12,785,138) |
| Total Liabilities and Net Position | $ 5,338,043 | $ 4,079,995 |

The accompanying notes are an integral part of these financial statements.

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## Statements of Operations and Changes in Net Position

For Fiscal Years Ended September 30, 1993 and 1992
(Dollars in Thousands)

| | 1993 | 1992 |
|---|---|---|
| **PROGRAM REVENUES AND EXPENSES** | | |
| **Program Revenues** | | |
| Estimated Collections under Special Legislation | $ 0 | $ 2,120,639 |
| Interest Earned on Funds Deposited with U.S. Treasury | 172,817 | 30,536 |
| Total Program Revenues | 172,817 | 2,151,175 |
| **Program Expenses** | | |
| Provision for Loan Defaults, Net | 1,091,577 | 2,048,235 |
| Provision for Interest Rate Subsidies, Net | 1,143,563 | 1,588,182 |
| Mandatory Administrative Expenses | 822,882 | 190,777 |
| Contractual Services | 37,755 | 15,732 |
| Interest Expense | 324,522 | 30,536 |
| Rent, Communications, and Utilities | 1,984 | 3,761 |
| Salaries and Benefits | 31,783 | 21,601 |
| Compensated Leave Expense | 78 | 55 |
| Administrative Services | 296 | 1,356 |
| Equipment, Materials, and Supplies | 329 | 776 |
| Interagency Agreements | 426 | 644 |
| Other Expenses, Net | 13,886 | 42,278 |
| Total Program Expenses | 3,469,081 | 3,943,933 |
| Net Operating Activity Before Extraordinary Item | (3,296,264) | (1,792,758) |
| Extraordinary Item: | | |
| Transfer to Treasury | 0 | (2,120,639) |
| Net Operating Activity | $ (3,296,264) | $ (3,913,397) |
| **CHANGES IN NET POSITION** | | |
| Net Position, Beginning Balance, as Previously Stated | $(12,785,138) | $(16,209,786) |
| Adjustments | 0 | 1,057,960 |
| Net Position, Beginning Balance, as Restated | (12,785,138) | (15,151,826) |
| Appropriated Funds Received | 6,539,777 | 7,936,353 |
| Appropriated Funds Returned | (692,574) | (1,656,268) |
| Subsidy Reestimate | (123,686) | 0 |
| Net Operating Activity | (3,296,264) | (3,913,397) |
| Net Position, End of Year | $(10,357,885) | $(12,785,138) |

The accompanying notes are an integral part of these financial statements.

## Statements of Cash Flows

For the Fiscal Year Ended September 30, 1993 and 1992
(Dollars in Thousands)

| | 1993 | 1992 |
|---|---|---|
| **CASH PROVIDED (USED) BY OPERATING ACTIVITIES:** | | |
| Cash Provided | | |
| Default Claim Principal Collected | $ 657,982 | $ 657,295 |
| Default Claim Interest Collected | 354,792 | 320,558 |
| Administrative Charges | 1,860 | 2,603 |
| Origination Fees | 509,912 | 422,362 |
| Reinsurance Fees | 35,066 | 49,330 |
| Penalty Fees | 40 | 43 |
| Other Fees | 8,397 | 8,356 |
| Collections on Advances to Guaranty Agencies | 1,047 | 1,745 |
| Interest Income | 172,817 | 30,536 |
| Other Operating Cash Provided | 0 | 7,492 |
| Total Operating Cash Provided | 1,741,913 | 1,500,320 |
| Cash Used | | |
| Default Claim Payments | (2,474,110) | (2,679,207) |
| Death, Disability, and Bankruptcy Payments | (354,144) | (176,536) |
| Interest Subsidy Payments | (1,760,938) | (1,748,853) |
| Special Allowance Payments | (106,657) | (223,593) |
| Closed School Payments | (1,277) | 0 |
| Mandatory Administrative Expenses | (170,774) | (158,101) |
| Salaries and Benefits | (28,621) | (21,684) |
| Rent, Communications, Utilities | (4,238) | (3,761) |
| Contractual Services | (34,416) | (17,732) |
| Supplies and Materials | (314) | (776) |
| Interest to U.S. Treasury | (151,705) | 0 |
| Other Operating Cash Used | (13,955) | (37,166) |
| Total Operating Cash Used | (5,101,149) | (5,067,409) |
| Net Cash Provided (Used) by Operating Activities | (3,359,236) | (3,567,089) |
| **CASH PROVIDED (USED) BY FINANCING ACTIVITIES:** | | |
| Appropriated Funds Received | 6,539,777 | 7,936,353 |
| Appropriated Funds Returned | (1,750,534) | (598,308) |
| Subsidy Reestimate | (123,686) | 0 |
| Borrowing from (payments to) U.S. Treasury | (31,696) | 2,090,103 |
| Funds Transferred to U.S. Treasury | 0 | (2,120,639) |
| Net Cash Provided (Used) by Financing Activities | 4,633,861 | 7,307,509 |
| Net Increase (Decrease) in Cash | 1,274,625 | 3,740,420 |
| Fund Balances with U.S. Treasury, Beginning of Year | 4,023,651 | 283,231 |
| Fund Balances with U.S. Treasury, End of Year | $ 5,298,276 | $ 4,023,651 |

The accompanying notes are an integral part of these financial statements.

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For the Fiscal Year Ended September 30, 1993 and 1992
(Dollars in Thousands)

| | 1993 | 1992 |
|---|---|---|
| RECONCILIATION OF NET OPERATING ACTIVITY BEFORE APPROPRIATIONS TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES | | |
| Net Operating Activity | $(3,296,264) | $(3,913,397) |
| Adjustments to Reconcile Net Operating Activity to Net Cash Provided (Used) By Operating Activities | | |
| Decrease (Increase) in Advances to Guaranty Agencies, Net | 1,036 | 868 |
| Decrease (Increase) in Accounts Receivable, Net | 15,541 | (14,013) |
| Increase (Decrease) in Liabilities for Loan Guarantees | (81,365) | (1,731,348) |
| Cost of Emergency Unemployment Act Benefit Extension | 0 | 2,090,103 |
| Increase (Decrease) in Accrued Salaries | 1,738 | 643 |
| Increase (Decrease) in Accrued Compensated Leave | 78 | 55 |
| Net Adjustments | (62,972) | 346,308 |
| Net Cash Provided (Used) by Operating Activities | $(3,359,236) | $(3,567,089) |

The accompanying notes are an integral part of these financial statements.

## Statements of Budgetary Resources and Actual Expenses

For the Fiscal Year Ended September 30, 1993 and 1992
(Dollars in Thousands)

| | 1993 | 1992 |
|---|---|---|
| **BUDGET** | | |
| **RESOURCES** | $7,011,885 | $7,571,410 |
| OBLIGATIONS | | |
| Direct | 5,873,450 | 4,226,649 |
| Reimbursed | 1,138,435 | 3,339,867 |
| **ACTUAL** | | |
| Program Expenses | 3,469,081 | 3,943,933 |
| Extraordinary Item | 0 | 2,120,639 |
| Total Expenses & Extraordinary Item | $3,469,081 | $6,064,572 |
| **BUDGET RECONCILIATION** | | |
| Total Expenses & Extraordinary Item | $3,469,081 | $6,064,572 |
| Add: | | |
| Other Expended Budget Authority | 4,089,943 | 4,919,408 |
| Other Expenditures Not Expensed | 0 | 31,838 |
| Less: Expenses and Extraordinary Item not Covered by Available Budgetary Resources | | |
| Extraordinary Item | 0 | 2,120,639 |
| Interest Expense | 172,817 | 0 |
| Salaries and Benefits | 9,738 | 0 |
| Annual Compensated Leave | 78 | 55 |
| Unfunded Program Expenses | 362,160 | 1,328,608 |
| Recoveries of Prior Years' Obligations | 51,359 | 102,098 |
| Contractual Services | 2,348 | 0 |
| Accrued Expenditures | 6,960,524 | 7,464,418 |
| Less Reimbursements | 1,138,435 | 3,339,867 |
| Accrued Expenditures, Direct | $5,822,089 | $4,124,551 |

The accompanying notes are an integral part of these financial statements.

## Notes to the Principal Financial Statements

U.S. DEPARTMENT OF EDUCATION
FEDERAL FAMILY EDUCATION LOAN PROGRAM

NOTES TO PRINCIPAL FINANCIAL STATEMENTS
SEPTEMBER 30, 1993 and 1992

### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation**

These financial statements have been prepared to report the financial position, results of operations and changes in net position, cash flows, and budgetary resources and actual expenses of the Federal Family Education Loan (FFEL) Program of the Department of Education, as required by the Chief Financial Officers Act of 1990 (Public Law 101-576). Education prepared them from the books and records of the FFEL Program in accordance with the FFEL Program's accounting policies, which are summarized in this note. These statements are therefore different from the financial reports, also prepared by Education for the FFEL Program pursuant to OMB directives, that are used to monitor and control the FFEL Program's use of budgetary resources.

FFEL Program's accounting policies follow an "other comprehensive basis of accounting," comprising the following hierarchy, agreed to by the Comptroller General, the Secretary of the Treasury and the Director of the Office of Management and Budget (OMB), who are Joint Financial Management Improvement Program (JFMIP) principals:

1. The accounting principles, standards and requirements approved by the three JFMIP principals.

2. Form and content requirements in OMB Bulletin 94-01, Form and Content of Agency Financial Statements, dated November 16, 1993, and subsequent issuances.

3. Accounting standards contained in agency accounting policy, procedures manuals, and/or related guidance as of March 29, 1991, so long as they are prevalent practices.

4. Accounting principles published by authoritative standard setting bodies and other authoritative sources (1) in the absence of other guidance in the first three parts of this hierarchy, and (2) if the use of such accounting standards improves the meaningfulness of the financial statements.

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NOTES TO PRINCIPAL FINANCIAL STATEMENTS
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OMB approved the following deviation from OMB Bulletin 94-01 in the FFEL Program's Principal Statements:

> The Statements of Operations and Changes in Net Position follow the format suggested in the Governmental Accounting Standards Board's Codification of Governmental Accounting and Financial Reporting Standards, which identifies a separate disclosure for the total effects of operations, exclusive of appropriations and intra-governmental funding sources.

Certain amounts from the fiscal year 1992 financial statements have been reclassified to conform with the current year's presentation.

**Reporting Entity**

The FFEL Program, formerly known as the Guaranteed Student Loan Program, is a program of the United States Department of Education (appropriation symbols 91X0230, 91X0231, and 91X4251). The FFEL Program was authorized by the Higher Education Act of 1965, as amended (HEA). As currently authorized, the program operates through state and private nonprofit guaranty agencies to provide insurance and interest supplements on loans made to eligible students attending participating postsecondary schools. The program uses private loan capital, supplied almost exclusively by commercial lenders, but in some instances by state agencies and schools. Loans disbursed under the program are guaranteed by guaranty agencies and reinsured by the federal government.

There are five FFEL Program components:

(1) Federal Stafford Loans (Subsidized) - under this component, need-based loans are made to undergraduate and graduate students. The federal government pays the loan interest while the student is in school and during certain grace and deferment periods;

(2) Unsubsidized Federal Stafford Loans - under this component, loans are made to undergraduate and independent graduate students. These loans do not have interest subsidies for borrowers. The first loans under this component, authorized by the HEA Amendments of 1992 (Public Law 102-325), were guaranteed during fiscal year 1993;

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NOTES TO PRINCIPAL FINANCIAL STATEMENTS
SEPTEMBER 30, 1993 and 1992

(3) Federal Parent Loans for Undergraduate Students (PLUS) - under this component, loans are made to parents of dependent students. These loans also do not have interest subsidies for borrowers;

(4) Federal Supplemental Loans to Students (SLS) - under this component, loans are made to graduate, professional, independent undergraduate, and certain dependent undergraduate students. These loans do not have interest subsidies for borrowers; and

(5) Federal Consolidated Loans - under this component, borrowers may have most of their FFEL Program obligations consolidated and their repayment schedules extended. Loans made under the Perkins and Health Professions Student Loan programs may also be consolidated under this component.

Each component has its own eligibility requirements and loan limits. The majority of loans guaranteed in fiscal years 1993 and 1992 were subsidized Federal Stafford Loans (approximately 70 percent and 76 percent of the dollar amounts guaranteed, respectively). By component, loans for fiscal years 1993 and 1992 were guaranteed as follows:

| | 1993 | |
|---|---|---|
| | Number of Loans | Dollar Amount (000s) |
| Stafford (Subsidized) | 4,172,782 | $12,455,956 |
| Stafford (Unsubsidized) | 425,315 | 1,015,089 |
| PLUS | 348,788 | 1,333,935 |
| SLS | 809,815 | 3,067,092 |
| Totals | 5,756,700 | $17,872,072 |

| | 1992 | |
|---|---|---|
| | Number of Loans | Dollar Amount (000s) |
| Stafford (Subsidized) | 3,996,860 | $11,249,660 |
| Stafford (Unsubsidized) | - 0 - | - 0 - |
| PLUS | 393,240 | 1,293,188 |
| SLS | 739,722 | 2,206,530 |
| Totals | 5,129,822 | $14,749,378 |

The Principal Statements of the FFEL Program include the accounts of all components of the program. The Principal Statements do not include the effects of centrally

U.S. DEPARTMENT OF EDUCATION
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NOTES TO PRINCIPAL FINANCIAL STATEMENTS
SEPTEMBER 30, 1993 and 1992

administered assets and liabilities related to the federal government as a whole, such as property and e· uipment and borrowings by the U.S. Treasury which may, in part, be attributable to the FFEL Program.

**Basis of Accounting**

Transactions are recorded on an accrual accounting basis and a budgetary basis. Under the accrual basis, revenues are recognized when earned and expenses are recognized when a liability is incurred, without regard to receipt or payment of cash. Budgetary accounting facilitates compliance with legal constraints and control over the use of Federal funds. The differences between the accrual basis recognition of expenses and the budgetary basis recognition of direct accrued expenditures are presented in the Statements of Budgetary Resources and Actual Expenses. For the purposes of this statement, obligations represent liabilities, primarily for loan guarantees, that will require payments from previous, current, or future period appropriations. Reimbursements include sums received for origination fees, reinsurance fees, collections on defaulted loans, and certain transfers from the Financing Account.

**Budgets and Budgetary Accounting**

The FFEL Program is an entitlement program and Education is authorized to incur obligations as necessary for mandatory program costs such as payments for interest subsidies and defaulted loans. This authority is based on the Higher Education Act, as amended. There is no limit on the volume of loans guaranteed. However, the costs of Federal administration of the FFEL Program are discretionary, and the authority to incur obligations for these costs is limited by annual appropriations acts.

The Federal Credit Reform Act of 1990 (CRA) was enacted to more accurately measure the costs of federal credit programs, place the cost of credit programs on a budgetary basis equivalent to other federal spending, encourage the delivery of benefits in the form most appropriate to the needs of the beneficiaries, and improve the allocation of resources among and between credit programs and other spending programs. The FFEL Program, as a credit program within Education, is required to conform with the provisions of CRA beginning with fiscal year 1992.

Due to enactment of CRA, there are two budget accounts for the FFEL Program activities: (1) a Liquidating Account to record all cash flows to and from the program resulting from loan guarantee commitments made prior to fiscal year 1992;

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NOTES TO PRINCIPAL FINANCIAL STATEMENTS
SEPTEMBER 30, 1993 and 1992

and (2) a Program Account to record subsidy costs associated with loan guarantee commitments made during fiscal year 1992 and beyond, as well as administrative expenses of the program. Administrative expenses include discretionary expenses for salaries, expenses, and overhead directly related to the program. Administrative expenses also include mandatory expenses such as administrative cost allowances, supplemental preclaims assistance payments and contract collection costs. For loans made prior to 1993, these mandatory expenses are separately identified on a cash basis. However, beginning with the 1993 cohort, mandatory administrative expenses are included in the FFEL estimate of subsidy costs of each year's cohort. (A cohort is a group of loan guarantees committed by the program in the same fiscal year.) The subsidy costs are estimated on a net present value basis and the Program Account receives appropriations for these costs. In addition to the budgetary accounts, the FFEL Program has a non-budgetary account called the Financing Account, which records all cash flows resulting from loan guarantee commitments made during fiscal year 1992 and beyond. The cash flows include the subsidy costs from the Program Account, interest earned on uninvested funds, and defaulted loan collections. The Statements of Budgetary Resources and Actual Expenses reflect the transactions of the Program and Liquidating Accounts only.

**Financing Sources and Program Revenues**

The FFEL Program receives the majority of the funding needed to support the program through appropriations. The FFEL Program is funded primarily by two appropriations: (1) an appropriation for its Liquidating Account (appropriation symbol 91X0230), and (2) an appropriation for its Program Account (appropriation symbol 91X0231).

The FFEL Program recognized program revenues during fiscal year 1992 for estimated future collections on defaulted loans resulting from enacted legislation. This legislation, the Emergency Unemployment Compensation Act of 1991 (Public Law 102-164) and the Higher Education Amendments of 1992, authorized collections on defaulted loans through offsets to borrowers' IRS tax refunds and wage garnishments and eliminated previously imposed time limitations on the collection period. In addition, under CRA, the FFEL Program receives interest income on uninvested funds in the Financing Account.

**Fund Balances With U.S. Treasury**

The FFEL Program does not maintain cash in commercial bank accounts. Cash receipts and disbursements are processed by the U.S. Treasury. The Fund

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NOTES TO PRINCIPAL FINANCIAL STATEMENTS
SEPTEMBER 30, 1993 and 1992

Balances with the U.S. Treasury are primarily appropriated funds that are available to pay current liabilities and finance subsidy expenses for post-1991 loans.

Liabilities

Liabilities represent the amount of monies or other resources that are likely to be paid by the FFEL Program as the result of a transaction or event that has already occurred. However, no liability can be paid by the FFEL Program absent an appropriation. Liabilities for which an appropriation has not been enacted are therefore classified as liabilities not covered by budgetary resources (unfunded liabilities). The majority of the FFEL Program's liabilities are considered entitlements and therefore the program is required to pay these liabilities if all eligibility requirements are met. Any non-entitlement liabilities of the FFEL Program, such as federal administrative costs, not arising from contracts, and entitlements not yet vested, can be abrogated by the government acting in its sovereign capacity.

Under the FFEL Program's accounting policies, liabilities for loan guarantees include provisions for payment of loan defaults, interest and special allowance benefits, mandatory administrative expenses (administrative cost allowances, supplemental preclaims assistance, and contract collection costs) and interest expense. The liabilities are offset by estimated future collections on loans that default, loan origination fees paid by lenders, and reinsurance fees paid by guaranty agencies.

In addition, a distinction is made between short-term and long-term liabilities. A short-term liability is anticipated to be paid within one year, whereas a long-term liability is anticipated to be paid beyond one year of the Statement of Financial Position date.

**Annual, Sick, and Other Leave**

Annual leave is accrued as it is earned and the accrual is reduced as leave is taken. Each year, the balance in the accrued annual leave account is adjusted to reflect current pay rates. To the extent current or prior year appropriations are not available to fund annual leave earned but not taken, funding will be obtained from future financing sources. Sick leave and other types of nonvested leave are expensed as taken.

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NOTES TO PRINCIPAL FINANCIAL STATEMENTS
SEPTEMBER 30, 1993 and 1992

Retirement Plan

FFEL Program employees participate in one of two retirement plans. The first plan is the Civil Service Retirement System (CSRS), to which the FFEL Program makes matching contributions equal to seven percent of pay. The second plan, the Federal Employees Retirement System (FERS), became effective on January 1, 1987, pursuant to Public Law 99-335. Employees hired prior to January 1, 1984, can elect to join either FERS and Social Security or remain in CSRS. A primary feature of FERS is that it offers a savings plan to FFEL Program employees, which automatically contributes one percent of pay and matches any employee contribution up to an additional four percent of pay. In addition, for employees covered under FERS, the FFEL Program also contributes the employer's matching share for Social Security. The FFEL Program does not report CSRS or FERS assets, accumulated plan benefits, or liabilities not covered by budgetary resources (unfunded liabilities), if any, applicable to its employees. Reporting such amounts is the responsibility of the Office of Personnel Management.

NOTE 2 - ADVANCES TO GUARANTY AGENCIES, NET

Advances to guaranty agencies represent amounts advanced to guaranty agencies under sections 422(a) and 422(c) of the HEA for commencement of agency operations and making loan default payments to lenders. The balances as of September 30, 1993 and 1992, were (in thousands):

| | 1993 | 1992 |
|---|---|---|
| Advances to Guaranty Agencies | $40,168 | $41,215 |
| Allowance for Doubtful Accounts | (401) | (412) |
| Advances to Guaranty Agencies, Net | $39,767 | $40,803 |

NOTE 3 - LIABILITIES FOR LOAN GUARANTEES

The liabilities for loan guarantees are estimated and stated at the net present value of the subsidy costs (i.e. interest rate differentials, interest subsidies, defaults, collection on defaulted loans, fee offsets, mandatory administrative expenses, and other cash flows) associated with loan guarantees. These costs are generally recognized in the year the loan guarantees are made for both accounting and budgetary purposes.

## U.S. DEPARTMENT OF EDUCATION
## FEDERAL FAMILY EDUCATION LOAN PROGRAM

### NOTES TO PRINCIPAL FINANCIAL STATEMENTS
### SEPTEMBER 30, 1993 and 1992

Liabilities for loan guarantees at September 30, 1993 and 1992 were (in thousands):

| | 1993 | | |
|---|---|---|---|
| | Pre-1992 Loans | Post-1991 Loans | Total |
| SHORT-TERM LIABILITIES | | | |
| Loan Defaults Payable | $3,053,107 | $1,206,974 | $ 4,260,081 |
| Interest & Special Allowance Benefits Payable | 802,000 | 1,067,662 | 1,869,662 |
| Mandatory Administrative Costs Payable | 76,810 | 5,477 | 82,287 |
| Collections on Defaulted Loans Receivable | (327,289) | (51,792) | (379,081) |
| Fees Receivable | (16,526) | (543,63[illegible] | (560,157) |
| Subtotal, Short-Term | 3,588,102 | 1,684,690 | 5,272,792 |
| LONG-TERM LIABILITIES | | | |
| Loan Defaults Payable | 2,214,659 | 4,119,711 | 6,334,370 |
| Interest & Special Allowance Benefits Payable | 1,419,846 | 1,803,008 | 3,222,854 |
| Mandatory Administrative Costs Payable | 1,227,603 | 119,760 | 1,347,363 |
| Fees Receivable | (174,669) | -0- | (174,669) |
| Collections on Defaulted Loans Receivable | (359,986) | (2,212,834) | (2,572,820) |
| Interest Payable | -0- | 203,353 | 203,353 |
| Subtotal, Long Term | 4,327,453 | 4,032,998 | 8,360,451 |
| TOTAL | $7,915,555 | $5,717,688 | $13,633,243 |
| | 1992 | | |
| | Pre-1992 Loans | Post-1991 Loans | Total |
| SHORT-TERM LIABILITIES | | | |
| Loan Defaults Payable | $2,961,089 | $ 259,324 | $ 3,220,413 |
| Interest & Special Allowance Benefits Payable | 1,263,000 | 781,758 | 2,044,758 |
| Mandatory Administrative Costs Payable | 45,522 | 3,266 | 48,788 |
| Collections on Defaulted Loans Receivable | (736,970) | (3,085) | (740,055) |
| Interest Payable | -0- | 30,536 | 30,536 |
| Fees Receivable | -0- | (177,066) | (177,066) |
| Subtotal, Short-Term | 3,532,641 | 894,733 | 4,427,374 |
| LONG-TERM LIABILITIES | | | |
| Loan Defaults Payable | 4,888,062 | 2,478,530 | 7,366,592 |
| Interest & Special Allowance Benefits Payable | 2,373,410 | 1,044,307 | 3,417,717 |
| Mandatory Administrative Costs Payable | 292,387 | 41,081 | 333,468 |
| Collections on Defaulted Loans Receivable | (1,189,927) | (640,616) | (1,830,543) |
| Subtotal, Long-Term | 6,363,932 | 2,923,302 | 9,287,234 |
| TOTAL | $9,896,573 | $3,818,035 | $13,714,608 |

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NOTES TO PRINCIPAL FINANCIAL STATEMENTS
SEPTEMBER 30, 1993 and 1992

A distinction is made in the FFEL Program's Principal Statements between liabilities covered by budgetary resources (funded) and liabilities not covered by budgetary resources (unfunded). The estimated costs of loan guarantees for pre-1992 loans are reported primarily as liabilities not covered by budgetary resources. The total liabilities for loan guarantees at September 30, 1993 and 1992 were (in thousands):

| | 1993 | | |
|---|---|---|---|
| | Short-Term | Long-Term | Total |
| Liabilities Covered by Budgetary Resources | $2,062,863 | $3,233,032 | $ 5,295,895 |
| Liabilities Not Covered by Budgetary Resources | 3,209,929 | 5,127,419 | 8,337,348 |
| Total | $5,272,792 | $8,360,451 | $13,633,243 |

| | 1992 | | |
|---|---|---|---|
| | Short-Term | Long-Term | Total |
| Liabilities Covered by Budgetary Resources | $1,430,743 | $1,549,846 | $ 2,980,589 |
| Liabilities Not Covered by Budgetary Resources | 2,996,631 | 7,737,388 | 10,734,019 |
| Total | $4,427,374 | $9,287,234 | $13,714,608 |

Education estimates that the outstanding balance of guaranteed loans was $69 and $63 billion at September 30, 1993 and 1992, respectively. Additionally, the outstanding balance of defaulted loans at September 30, 1993 and 1992 was about $11 billion and $12 billion, respectively.

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### NOTES TO PRINCIPAL FINANCIAL STATEMENTS
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Subsidy expense for the FFEL program incurred in fiscal years 1993 and 1992 were (in thousands):

| | FY 1993 | FY 1992 |
|---|---|---|
| Current Year's Estimate | | |
| Provision for Loan Defaults (Net) | $1,452,945 | $2,048,235 |
| Provision for Interest Rate Subsidies (Net) | 1,047,509 | 1,588,182 |
| Mandatory Administrative Expense | 249,045 | 190,777 |
| Interest Expense | 35,923 | 30,536 |
| Subtotal, Current Year's Estimate | 2,785,422 | 3,857,730 |
| Modifications | | |
| Fiscal Year 1992 loans | - 0 - | - 0 - |
| Pre-1992 loans | - 0 - | - 0 - |
| Subtotal, Modifications | - 0 - | - 0 - |
| Reestimates | | |
| Fiscal Year 1992 loans | 104,025 | - 0 - |
| Pre-1992 loans | 493,097 | - 0 - |
| Subtotal, Reestimates | 597,122 | - 0 - |
| Total Subsidy Expense | $3,382,544 | $3,857,730 |

### NOTE 4 - DUE TO U.S. TREASURY

During its fiscal year 1992 mid-session reviews of the FFEL Program's subsidy costs, Education concluded that $1.058 billion of funds drawn from the appropriation for the Program Account would not be needed. This amount is included in the principal statements as Due to U.S. Treasury. The amount was transferred to Treasury during fiscal year 1993.

### NOTE 5 - BORROWING FROM U.S. TREASURY

On September 30, 1992, the FFEL Program borrowed $2.09 billion from the U.S. Treasury in accordance with OMB instructions under the CRA on accounting for noncontractual modifications made to its loan guarantees. The FFEL Program will repay the borrowing with collections on defaulted loans resulting from the noncontractual modifications. These collections are expected to occur over a period of seven years. During fiscal year 1993, the FFEL Program used collections to reduce the balance of its Treasury debt as follows (in thousands):

| | |
|---|---|
| Borrowing from U.S. Treasury, Balance 10/1/92 | $2,090,103 |
| Payment on Outstanding Balance, 1993 | (31,696) |
| Borrowing from U.S. Treasury, Balance 9/30/93 | $2,058,407 |

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The revised aggregate maturities of this debt, based on estimated collections on defaulted loans, for the years subsequent to September 30, 1993, are as follows (in thousands):

| | |
|---|---|
| 1994 | $ 453,092 |
| 1995 | 471,137 |
| 1996 | 453,956 |
| 1997 | 326,149 |
| 1998 | 237,302 |
| 1999 | 116,771 |
| | $2,058,407 |

Interest on the borrowing is paid annually at 7.37 percent. (Also see Note 11, Extraordinary Item.)

NOTE 6 - NET POSITION

The FFEL Program's Net Position, at September 30, 1993 and 1992, included:

**Invested Capital** - which are amounts advanced to guaranty agencies under sections 422(a) and 422(c) of the HEA for commencement of agency operations and making loan default payments to lenders.

**Future Funding Requirements** - which is the net amount of financial resources that will be required in the future to liquidate liabilities not covered by available budgetary resources.

NOTE 7 - APPROPRIATED FUNDS RECEIVED AND RETURNED

The FFEL Program draws on appropriated funds for the Liquidating Account to pay the costs of pre-1992 loans, and for the Program Account to pay the costs of post-1991 loans. Appropriated funds received for the Liquidating Account and Program Account were (in thousands):

| | 1993 | 1992 |
|---|---|---|
| Liquidating Account | $3,767,211 | $4,226,391 |
| Program Account | 2,772,566 | 3,709,962 |
| | $6,539,777 | $7,936,353 |

The fiscal years 1993 and 1992 mid-session reviews of the FFEL Program's subsidy costs determined that funds drawn from the Liquidating Account's and Program

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Account's appropriations would not be needed during the fiscal years. Appropriated funds returned to Treasury from the Liquidating Account and Program Account were (in thousands):

| | 1993 | 1992 |
|---|---|---|
| Liquidating Account | $682,107 | $ 598,308 |
| Program Account | 10,467 | 1,057,960 |
| | $692,574 | $1,656,268 |

Included in the Program Account's fiscal year 1993 appropriated funds returned are $2 million that the appropriation legislation earmarked for two commissions which were not subsequently established, the Commission on the Cost of Higher Education and the National Commission on Independent Higher Education. The Program Account's fiscal year 1992 appropriated funds to be returned to Treasury were transferred during fiscal year 1993.

## NOTE 8 - SUBSIDY REESTIMATE

In accordance with OMB guidance, the subsidy cost of a cohort of guaranteed loans must be reestimated at the beginning of each fiscal year following the year in which the initial disbursement was made as long as the loans are outstanding. This year the reestimate indicated a net decrease in the subsidy cost of the fiscal year 1992 cohort as a whole. Accordingly, an outlay of $123.7 million was made to a special fund receipt account established for the program. The receipts in the special fund receipt account are earmarked for the FFEL Program and are available by appropriation for the subsidy cost of new guaranteed loans or subsequent higher cohort reestimates.

In the future if reestimates indicate a net increase in the subsidy cost of any cohort as a whole, an outlay will be made from the Program Account to the Financing Account.

## NOTE 9 - COVERAGE OF EXPENSES BY BUDGETARY RESOURCES

OMB Bulletin 94-01 eliminated the requirement that the Statement of Operations display those expenses covered by budgetary resources (funded) separately from expenses not covered by budgetary resources (unfunded). However, Education's Chief Financial Officer considers this separation to be an important indicator of the FFEL Program's true costs.

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SEPTEMBER 30, 1993 and 1992

Expenses (funded and unfunded) for the FFEL Program for fiscal years 1993 and 1992 were (in thousands):

| | 1993 | | |
|---|---|---|---|
| | Funded | Unfunded | Total |
| Provision for Loan Defaults, Net | | | |
| Loan Defaults | $2,753,838 | $ - 0 - | $ 2,753,838 |
| Collections | (1,605,565) | - 0 - | (1,605,565) |
| Reinsurance Fees | (56,696) | - 0 - | (56,696) |
| Subtotal, Provision for Loan Defaults, Net | 1,091,577 | - 0 - | 1,091,577 |
| Provision for Interest Rate Subsidies, Net | | | |
| Interest & Special Allowance Benefits | 1,776,083 | 191,880 | 1,967,963 |
| Origination Fees | (824,400) | - 0 - | (824,400) |
| Subtotal, Prov. for Interest Rate Subsidies, Net | 951,683 | 191,880 | 1,143,563 |
| Mandatory Administrative Expenses | 666,489 | 156,393 | 822,882 |
| Interest Expense | 324,522 | - 0 - | 324,522 |
| Total Subsidy Expense | 3,034,271 | 348,273 | 3,382,544 |
| Other Expenses, Net | - 0 - | 13,886 | 13,886 |
| Total Expenses before Salaries and Administrative | 3,034,271 | 362,159 | 3,396,430 |
| Salaries and Administrative Expenses | | | |
| Salaries and Benefits | 22,045 | 9,738 | 31,783 |
| Compensated Leave Expense | - 0 - | 78 | 78 |
| Contractual Services | 35,407 | 2,348 | 37,755 |
| Administrative Services | 296 | - 0 - | 296 |
| Rent, Communications and Utilities | 1,984 | - 0 - | 1,984 |
| Equipment, Materials and Supplies | 329 | - 0 - | 329 |
| Interagency Agreements | 426 | - 0 - | 426 |
| Total Salaries and Admin. Expenses | 60,487 | 12,164 | 72,651 |
| Total Program Expenses | $3,094,758 | $ 374,323 | $3,469,081 |

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| | 1992 | | |
|---|---|---|---|
| | Funded | Unfunded | Total |
| Provision for Loan Defaults, Net | | | |
| Loan Defaults | $1,957,572 | $ 780,508 | $2,738,080 |
| Collections | (643,701) | - 0 - | (643,701) |
| Reinsurance Fees | (46,144) | - 0 - | (46,144) |
| Subtotal, Provision for Loan Defaults, Net | 1,267,727 | 780,508 | 2,048,235 |
| Provision for Interest Rate Subsidies, Net | | | |
| Interest & Special Allowance Benefits | 1,544,373 | 508,272 | 2,052,645 |
| Origination Fees | (464,463) | - 0 - | (464,463) |
| Subtotal, Provision for Interest Rate Subsidies, Net | 1,079,910 | 508,272 | 1,588,182 |
| Mandatory Administrative Expenses | 150,949 | 39,828 | 190,777 |
| Interest Expense | 30,536 | - 0 - | 30,536 |
| Total Subsidy Expense | 2,529,122 | 1,328,608 | 3,857,730 |
| Other Expenses, Net | 42,278 | - 0 - | 42,278 |
| Total Expenses before Salaries & Administrative | 2,571,400 | 1,328,608 | 3,900,008 |
| Salaries and Administrative Expenses | | | |
| Salaries and Benefits | 21,601 | - 0 - | 21,601 |
| Compensated Leave Expense | - 0 - | 55 | 55 |
| Contractual Services | 15,732 | - 0 - | 15,732 |
| Administrative Services | 1,356 | - 0 - | 1,356 |
| Rent, Communications and Utilities | 3,761 | - 0 - | 3,761 |
| Equipment, Materials and Supplies | 776 | - 0 - | 776 |
| Interagency Agreements | 644 | - 0 - | 644 |
| Total Salaries and Admin. Expenses | 43,870 | 55 | 43,925 |
| Total Program Expenses | $2,615,270 | $1,328,663 | $3,943,933 |

Interest expense is comprised of the payment of interest on subsidy (uninvested funds) and the interest accrued on borrowings under the Emergency Unemployment Compensation Act of 1991 and the Higher Education Amendments of 1992, disclosed in Note 11. For fiscal years 1993 and 1992, interest expense was (in thousands):

| | | | 1993 | 1992 |
|---|---|---|---|---|
| Interest on Borrowings under fiscal year 1992 Special Legislation | | | $ 151,705 | $ - 0 - |
| Payment of Interest on Subsidy | FY92 $ | 137,524 | | 30,536 |
| | FY93 | 35,293 | 172,817 | -- |
| Balance | | | $ 324,522 | $30,536 |

The increase in fiscal year 1993 interest expense is due to recognizing a full year's interest on uninvested funds for fiscal year 1992 of $137.5 million, plus payment of $151.7 million Treasury borrowing not incurred in fiscal year 1992.

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## NOTE 10 - OTHER EXPENSES, NET

Expenses recorded as "Other Expenses, Net" consist primarily of the additional costs for current loans resulting from the Higher Education Amendments (HEA) of 1992. These costs included guaranty agency cash reserve repayments and increased costs for bankruptcy claims for pre-1992 loans as follows (in thousands):

| | 1993 | 1992 |
|---|---|---|
| Guaranty Agency Cash Reserve Repayments | $13,954 | $ 7,758 |
| Bankruptcy Claim for Pre-1992 Loans, Increased Costs | 0 | 49,391 |
| Other | (68) | (14,871) |
| Total | $13,886 | $42,278 |

## NOTE 11 - EXTRAORDINARY ITEM

In fiscal year 1992, the FFEL Program incurred an extraordinary item associated with legislation, which extended unemployment benefits and enhanced Education's collection authority. The Emergency Unemployment Compensation Act of 1991 and the Higher Education Amendments of 1992, contained noncontractual modifications to the program's guarantees. The modifications were:

- The Emergency Unemployment Compensation Act of 1991 - authorized Education to continue collecting on defaulted loans through the Internal Revenue Service (offsetting income tax refunds). Authority to collect on defaulted loans by offsetting tax refunds was due to expire in fiscal year 1994. The act also authorized the use of wage garnishment as a collection tool for defaulted student loans.

- The Higher Education Amendments of 1992 - eliminated the statute of limitations on collections activities for certain student loans.

The net present value of funds Education expects to collect on defaulted loans because of these modifications is $2.121 billion at September 30, 1992. This amount was used for purposes of the Budget Enforcement Act of 1990 (P.L. 101-508) to offset the cost of extending unemployment benefits. However, no monies available for the FFEL Program were actually used to pay unemployment compensation.

Consistent with CRA and OMB's implementing instructions, Education executed a series of transactions to account for the expected future savings from the

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noncontractual modifications. The FFEL Program borrowed $2.09 billion from the U.S. Treasury (also see Note 5, Borrowing from U.S. Treasury). These borrowed funds and $31 million in interest earnings (on funds appropriated to pay subsidy costs associated with fiscal year 1992 loan guarantees) were transferred to Treasury for a total transfer of $2.121 billion. These funds were recognized in the fiscal year 1992 Statement of Operations and Changes in Net Position as a program revenue and an extraordinary item, and in the Statement of Financial Position as of September 30, 1992, as a reduction to liabilities for loan guarantees and as a borrowing from U.S. Treasury.

## NOTE 12 - PRIOR PERIOD ADJUSTMENTS

As described in Note 4, during fiscal year 1992 Education recognized a liability in the amount of $1.058 billion for appropriated funds to be returned to Treasury. The previously issued Statement of Changes in Net Position for fiscal year 1992 should have reported this amount as appropriated funds returned, but rather showed it as a reduction of the net position as of September 30, 1991. This error caused the reported net position balance as of September 30, 1991 to be understated by $1.058 billion and the appropriated funds returned in fiscal year 1992 to be understated by the same amount. To correct this error, the 1992 Statement of Operations and Changes in Net Position has been restated to report the appropriations returned and adjust the beginning balance of net position.

## NOTE 13 - COMMITMENTS AND CONTINGENCIES

### Guaranty Agency Advances and Reserve Funds

Cumulative outstanding loan guarantees were approximately $69 billion at September 30, 1993. These loans are guaranteed by 46 guaranty agencies, operating in 50 states, Washington, D.C., and several U.S. territories. Prior to 1965, guaranty agencies existed in 17 states. The Higher Education Act of 1965 provided that advances be made in the form of "seed money" to existing guaranty agencies and for assisting in the formation of guaranty agencies in all states. As of September 30, 1993, there was $40.2 million outstanding in advances to guaranty agencies. (Also see Note 2, Advances to Guaranty Agencies, Net).

The aggregate balance of reserves at the guaranty agencies was $1.7 billion and $1.3 billion at September 30, 1993 and 1992, respectively. Reserves are comprised of

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federal reinsurance payments, insurance premiums, collections on defaulted loans (agencies are allowed to keep 30 percent of all funds collected to cover collection costs), investment income, administrative cost allowances and federal advances. Disbursements from reserves are allowed for lender claims, operating expenses, reinsurance fees, and to remit to Education its share (70 percent) of collections on defaulted loans.

The Omnibus Budget Reconciliation Act of 1993 (Public Law 103-66), which includes the Student Loan Reform Act of 1993, authorized Education as it deems appropriate, to recover the cash reserves and any assets purchased with reserve funds regardless of who holds or controls them and thus impacts the accounting for guaranty agency reserves. However, these reserves are not reported in the principal statements of the FFEL Program since Education's recovery of these amounts is contingent on the Secretary's determination that such recovery would be appropriate.

**Financial Difficulties of Guaranty Agencies**

On October 31, 1990, Education entered into agreements with the Student Loan Marketing Association (SLMA, also known as Sallie Mae) to wind down the operations of the Higher Education Assistance Foundation (HEAF), the largest guaranty agency participating in the FFEL Program at that time. HEAF was essentially financially insolvent and was unable to pay lenders' default claims. Under the agreements, SLMA agreed to manage HEAF's wind down over a three year period ending on December 31, 1993. SLMA is responsible for disbanding HEAF and distributing its outstanding guarantees to other guaranty agencies. Education allowed HEAF to retain the full amount of collections on defaulted loans during the three-year period and agreed to pay HEAF 100 percent reinsurance without regard to default rate. The majority of HEAF's net cash assets which amounted to $300 million (minus a small reserve fund to pay contingent liabilities) was returned to Education on March 31, 1994. A deposit fund account entitled "HEAF Claims Reserves" was established to hold the assets until no longer required to meet claims against HEAF. At that time, the funds will be treated as a collection in the Liquidating Account. In addition, HEAF has established a reserve fund of $34.7 million to provide for any successfully asserted lawsuits against HEAF in the future.

Loan guarantees not distributed to other guaranty agencies as of December 31, 1993, will be managed by SLMA. SLMA will be responsible for all costs associated with managing this portfolio except for default claims. Education will continue to pay the applicable reinsurance for default claims on these guarantees. These defaults will

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immediately be assigned to Education for collection. The net cost of loan defaults guaranteed by HEAF is included in the FFEL Program's liabilities for loan guarantees.

In addition, Education assisted other guaranty agencies experiencing financial difficulties through advancement of funds and other means. No provision has been made in the principal statements for potential liabilities related to financial difficulties of guaranty agencies, because the likelihood of such liabilities occurring is uncertain and cannot be estimated with sufficient reliability.

**SLMA Debt Obligations**

The Higher Education Act of 1965, as amended, authorized Education to guarantee payment of principal and interest on certain SLMA debt obligations issued by the U.S. Treasury prior to October 1, 1984. It also provides Education with borrowing authority and further authorizes appropriations, as necessary, for repayment of funds borrowed in discharging the guarantee obligation. SLMA is a shareholder-owned corporation chartered by Congress in the Education Amendments of 1972 (Public Law 92-318) to expand funds available for student loans by purchasing student loans and thus providing liquidity to lenders originating such loans. SLMA's borrowed amounts were consolidated into one loan of $5 billion in 1982. Loan principal payments of $30 million are made on an annual basis with a $4.3 billion balloon payment due in 1996 and a final $400 million payment in 1997. The floating rate notes bear interest at 0.125 percentage points above the average rate of the weekly 91-day Treasury bill auctions. The outstanding principal balance of SLMA's debt obligation at September 30, 1993 and 1992, is $4.79 billion and $4.82 billion, respectively. As of March 2, 1994, SLMA repaid the total outstanding balance of $4.79 billion.

**Borrower Class Actions**

Education is involved in pending litigation challenging the enforceability of FFEL Program loans made to students who attended various trade schools that have closed. In most instances, a large percentage of the loans in question are in default and have been acquired by guaranty agencies and reimbursed by Education. Thus, Education has already incurred losses from payment of defaults. No provision has been made in the principal statements for any potential reductions in estimated future collections related to the outcome of these suits, since Education's potential loss exposure is uncertain and cannot be estimated with sufficient reliability.

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**Federal Direct Student Loan Program**

On August 10, 1993, President Clinton signed the Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66). A portion of that Act entitled "The Student Loan Reform Act of 1993" requires the phase-in of federal direct student lending. Direct student lending, as a percentage of new student loan volume will be phased in over five years as follows:

| Academic Year | Percent |
|---|---|
| 1994-95 | 5% |
| 1995-96 | 40% |
| 1996-97 | at least 50% |
| 1997-98 | at least 50% |
| 1998-99 | at least 60% |

The Student Loan Reform Act of 1993 ensures adequate financing for the current guaranty agencies during the transition and provides for alternative mechanisms to assure loan guarantees in the event that any of the guaranty agencies do not continue to operate. The implementation plans for the new direct loan program provide for Education's cost of transitioning outstanding guaranteed loans, therefore no provision for such cost has been included in the principal statements.

**Other Matters**

Education is involved in various other claims and legal actions related to the FFEL Program arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material effect on the Principal Statements of the FFEL Program.

# Objectives, Scope, and Methodology

Management is responsible for

- preparing the annual financial statements in conformity with applicable accounting principles,
- establishing and maintaining internal controls and systems to provide reasonable assurance that the broad control objectives of the Federal Managers' Financial Integrity Act are met, and
- complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether (1) the Principal Statements are reliable (free of material misstatements and presented fairly in accordance with applicable accounting principles) and (2) relevant internal controls are in place and operating effectively. We are also responsible for testing compliance with significant provisions of selected laws and regulations and for performing limited procedures with respect to certain other information appearing in these annual financial statements.

In order to fulfill these responsibilities, we

- examined, on a test basis, evidence supporting the amounts and disclosures in the Principal Statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the Principal Statements;
- evaluated and tested relevant internal controls which encompassed financial reporting, cash receipts, cash disbursements, compliance, and budget;
- tested compliance with significant provisions of the following laws and regulations:
  - Part B of Title IV of the Higher Education Act of 1965, as amended (20 U.S.C. 1071-1087-2),
  - Federal Credit Reform Act of 1990 (Public Law 101-508),
  - Chief Financial Officers Act of 1990 (Public Law 101-576),
  - Federal Managers' Financial Integrity Act of 1982 (Public Law 97-255),
  - 34 Code of Federal Regulations, Part 682, and
  - reviewed Education's compliance with:
  - OMB Bulletin 94-01, "Form and Content of Agency Financial Statements," and
  - OMB Bulletin 93-18 "Audited Financial Statements."

We did not evaluate all internal controls relevant to operating objectives as broadly defined by FMFIA, such as those controls relevant to preparing statistical reports and ensuring efficient operations. We limited our work to accounting and other controls necessary to achieve the objectives outlined in our opinion on internal controls.

Except for the limitations on the scope of our work in testing the liabilities for loan guarantees, our work was done in accordance with generally accepted government auditing standards and OMB Bulletin 93-06, "Audit Requirements for Federal Financial Statements."

While we examined guaranty agency records in preparation for this report, we did not focus on Education's use of guaranty agency data in calculating school default rates. Hence, this report does not address the Department's procedures for determination of school default rates or for considering requests from educational institutions for recalculation of those default rates. We have not examined this process, and therefore express no opinion as to its efficacy.

The Department of Education's Under Secretary, Assistant Secretary for Postsecondary Education, and Chief Financial Officer provided comments on a draft of this report. These comments are discussed in the "Agency Comments and Our Evaluation" section of the opinion letter and are reprinted in appendix III. We have also incorporated agency views where appropriate.

# Status of Fiscal Year 1992 Financial Audit Recommendations

We determined the status of the following recommendations based on our audit work at Education during fiscal year 1993 and on our discussions with Education officials. However, we have not fully assessed the appropriateness or effectiveness of all of the responses identified in the table below.

| Report/Recommendations | Action complete | Action in progress | Action planned | No specific action planned |
|---|---|---|---|---|
| **Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement** (GAO/AFMD-93-20, March 16, 1993) | | | | |
| The Congress amend the Higher Education Act to require that originating lenders pay loan origination fees even if the loan is subsequently sold to another lender. | | | X | |
| Require that guaranty agencies and lenders annually provide Education an independent public accountant's positive attestation on the claims for payment submitted to the federal government, and the basis for such attestation, including an opinion on the adequacy of internal controls over such claims. | | X | | |
| Test billings from guaranty agencies and lenders as part of its internal reviews. | | X | | |
| Require staff to follow up on questioned costs and other amounts owed based on reviews of guaranty agencies and lenders within a designated period of time from the time findings are reported | | X | | |
| Study the feasibility of requiring guaranty agencies to standardize their FFELP loan accounting systems. | | | | X[a] |
| Reassess and, if appropriate, adjust the NSLDS implementation date after completion of a detailed system design. | | X | | |
| Develop written procedures detailing the methodology to be used to derive the financial statement estimate of loan guarantee subsidies and require that each year's estimate be fully documented and approved by the Department's CFO office. | X | | | |
| Establish and maintain subsidiary ledgers for the FFELP. | | X | | |
| Develop procedures to ensure that the general ledger is periodically reconciled to subsidiary records maintained by OPE. | | X | | |

(continued)

| Report/Recommendations | Action complete | Action in progress | Action planned | No specific action planned |
|---|---|---|---|---|
| Establish an acceptance testing group responsible for independently testing FFELP application system changes prior to implementation. | X | | | |
| Implement controls described in the Department's ADP Technical Controls Handbook to ensure that all data received from guaranty agencies and lenders is consistent and accurate. | X | | | |
| Implement procedures to ensure that internal control reviews and risk assessments of the FFELP information systems are performed periodically as required by OMB Circulars A-123, Internal Control Systems, A-127, Financial Management Systems, and A-130, Management of Federal Information Resources. | X | | | |
| Enhance the existing computer disaster recovery plan to include contingency options at Education headquarters and regional offices regarding key original documents. | X | | | |
| Require that the security administrator and appropriate supporting technical staff have formal training in the specific operating systems and access control software used by the FFELP contractor. | | X | | |
| Develop a comprehensive plan for revising the role of guaranty agencies and the manner in which they are compensated. | | | | X[a] |
| **Financial Management: Education's Student Loan Program Controls Over Lenders Need Improvement** (GAO/AIMD-93-33, September 9, 1993) | | | | |
| Develop a comprehensive strategy for determining the accuracy of information reported on lender's quarterly billings. | | X | | |
| Monitor and follow up with lenders whose quarterly billings fail to meet Education's internal automated edit checks and reasonability tests | | X | | |
| Develop and implement procedures for converting major automated systems, including a requirement that parallel systems be run for an appropriate period of time, to ensure that new systems are properly processing program data. | X | | | |

[a]The Federal Direct Student Loan Program, which was established in 1993, will revise the role of guaranty agencies since FFELP is expected to significantly phase down over the next 5 years

# Comments From the Department of Education

UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON, D.C. 20202-4300

JUN 21 1994

Charles A. Bowsher
Comptroller General
of the United States
Washington, DC 20548

James B. Thomas, Jr.
Inspector General
U.S. Department of Education
Washington, DC 20202

Dear Gentlemen:

The Secretary has asked that we respond to your request for comments on the draft report on the financial statements of the Federal Family Education Loan Program for the fiscal year ended September 30, 1993.

We appreciate the opportunity to comment on the report. As noted, the Department has worked hard to improve the management of the program and plans to continue this effort.

Actions that have been taken by the Department to manage the student loan program more effectively include: the recruitment of top notch managers; reassignment of knowledgeable staff to program functions; building and training new staff; designing new ways of performing cost estimates; developing new systems; improving gatekeeping functions; placing greater attention on guarantee agency oversight; actively pursuing legislative changes to reform the Student Loan Program; and planning for the transition from guaranteed lending to direct lending. Also ongoing, in the Office of Postsecondary Education, are reorganizational and other process improvement efforts aimed at providing better customer-driven programs, reducing supervisory layering, and improving delivery of and accountability over SFA funds.

With respect to the recommendations in the report regarding the financial statements and internal controls, we are in general agreement. We do need to further analyze the specific recommendations to determine the best way to proceed to achieve the desired results. We plan to do so promptly and take all appropriate corrective actions.

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In response to the comments in the report regarding the Department's organization, we feel strongly that the Department's current structure is essential to our reinvention efforts by pulling together all policy development functions and, at the same time, strengthening the Chief Financial Officer's function.

About 98 percent of the Department's $30 billion annual budget supports educational programs, each with its own legislative statute, involving numerous policy implications within the context of the Federal role in education. Thus, the legislative development and budget processes within the Department are integrally interwoven with policy making. For this reason, Secretary Riley established, with approval from the White House and OMB, an organizational structure that combines budget, legislative development, program evaluations, long-range planning, and policy development into one organizational entity, headed by the Under Secretary, to direct and coordinate these functions within the Department.

At the same time, the financial management of the Department has been strengthened by combining the financial management and procurement functions under the CFO. The CFO not only plays a key role along with the Department's Senior Officers in the policy making processes, but also brings a financial management perspective to the Department's overall management and program administration through a variety of mechanisms such as participation in the Executive Management Committee, work groups on the Direct Student Loan and other student financial aid programs, and through follow up of audit findings. In addition, as indicated in the draft report, we believe that the current organizational structure protects financial management from being overshadowed by budget issues.

We look forward to the continuing cooperative effort to improve program management and better serve the participants in this program and the taxpayers. If you have any questions, please contact Mitchell L. Laine, Deputy Chief Financial Officer, at 401-0207.

Sincerely yours,

Marshall S. Smith
Under Secretary

David A. Longanecker
Assistant Secretary for
Postsecondary Education

Donald R. Wurtz
Chief Financial Officer

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# Related GAO and OIG Reports

Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement (GAO/AFMD-93-20, March 16, 1993)

Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Year 1992 (GAO/AIMD-93-04, June 30, 1993)

Financial Management: Education's Student Loan Program Controls Over Lenders Need Improvement (GAO/AIMD-93-33, September 9, 1993)

Guaranteed Student Loans (GAO/HR-93-2, December 1992)

Education Issues (GAO/OCG-93-18TR, December 1992)

Student Loans: Direct Loans Could Save Billions in First 5 Years With Proper Implementation (GAO/HRD-93-27, November 25, 1992)

Stafford Student Loans: Prompt Payment of Origination Fees Could Reduce Costs (GAO/HRD-92-61, July 24, 1992)

Direct Student Loans: The Department of Education's Implementation of Direct Lending (GAO/T-HRD-93-26, June 10, 1993)

OPE's Lender and Guarantee Agency Oversight Function Should Focus More on Audit Follow-Up (ACN 11-20015, December 1, 1992)

Development and Implementation of the National Student Loan Data System Needs to be Expedited (OIG Semiannual Report-25)

Review of the Performance of the Guaranteed Student Loan Branches (ACN 04-20075, January 28, 1994)

The Secretary's Default Reduction Initiative: An Alternative Approach to Implementing Sanctions (MIR 93-07, September 14, 1993)

Attention Is Needed to Improve the Department's Financial Management Systems (OIG Semiannual Report-24)

Loan Servicers for the Guaranteed Student Loan Programs Need to be Better Controlled to Save ED Millions in GSLP Losses (MIR 92-12, August 19, 1992)

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